

**SUBSIDIES ENFORCEMENT  
ANNUAL REPORT TO THE CONGRESS**

**Joint Report of the  
Office of the United States Trade Representative  
and the  
U.S. Department of Commerce**

**FEBRUARY 2001**

## Executive Summary

As part of the U.S. government's commitment to the vigorous enforcement of trade agreements and to ensuring our trading partners' adherence to the terms of those agreements, the Office of the U.S. Trade Representative (USTR) and the Department of Commerce (Commerce) have continued their close collaboration to monitor and strictly enforce the obligations of the Agreement on Subsidies and Countervailing Measures (Subsidies Agreement, or Agreement). The Subsidies Agreement, administered by the World Trade Organization (WTO), establishes multilateral disciplines on subsidies, including effective mechanisms for challenging government programs that are in violation of the Subsidies Agreement and remedies for subsidies affecting competition in foreign markets.

The United States pursues enforcement of U.S. rights under the Subsidies Agreement through WTO dispute settlement proceedings, bilateral contacts and other actions. USTR is charged with leading this effort. Our general and overarching policy objectives remain aimed at discouraging distortive subsidization and preventing or remedying harm caused to U.S. producers and workers by such subsidies. For example, during this past year in WTO dispute settlement cases involving subsidized leather imports from Australia and dairy imports from Canada, the United States prevailed in its claims and these countries were required to bring their export subsidy programs into compliance with international rules. Further, within the WTO Subsidies Committee (Subsidies Committee, or Committee) and the WTO General Council, the United States continued to work towards full and timely compliance by WTO Members with their subsidy obligations. In each setting, however, we also strove to work pragmatically to resolve legitimate implementation problems and to seek ways to lessen the burden of meeting obligations without diminishing their substance.

Throughout this process, USTR and Commerce work closely with one another and with the full range of federal agencies. This interagency cooperation is also crucial to the success of our efforts to protect and defend U.S. interests in other circumstances involving subsidy rules, such as in the assistance we provide to U.S. exporters and respondent agencies subject to foreign countervailing duty (CVD) actions, as Canada's CVD investigation of grain corn from the United States, and in the explanation and defense of U.S. measures targeted by other countries in WTO dispute settlement.

At Commerce, the key player in the government's enforcement activities is the Subsidies Enforcement Office (SEO). The main mission of the SEO is to examine subsidy complaints and concerns raised by U.S. exporters and to monitor foreign subsidy practices to determine whether they are impeding U.S. exports and are inconsistent with the Subsidies Agreement. To this end, for the fourth year in a row, Commerce has committed additional personnel and resources to the Subsidies Enforcement Office in order to enhance its ability to reach out to and assist the private sector. During this past year, SEO staff have handled numerous inquiries and met with representatives of U.S. industries concerned about the subsidization of foreign competitors. This year, we are

particularly pleased to report that the electronic subsidies database has been completed. The completion of the database is the product of three years of intensive efforts by SEO staff reviewing hundreds of countervailing duty cases, summarizing government practices investigated and linking these summaries directly into the published decisions of Commerce.

In addition, during 2000, the SEO has been engaged in certain focused areas of work, having led or been involved in the preparation of several studies and reports on subsidy practices affecting specific industries in various countries, *e.g.*, the steel and film industries. These groundbreaking reports provide in-depth analysis of the trade issues confronting these industries, including whether foreign governments have been providing assistance to support their industries.

In the coming year, the Administration will continue to work pro-actively with the private sector to identify foreign subsidy practices which may pose problems for U.S. interests, and will respond appropriately to subsidy barriers faced by U.S. exporters in third country markets.

## **INTRODUCTION**

Through a combination of statutory mandate, concerted policy and longstanding practice, USTR and Commerce have fulfilled separate yet complementary missions to ensure that U.S. trade policy responds appropriately to the challenges facing U.S. interests from foreign subsidy practices and policies. Commerce's Import Administration is charged with administering the U.S. CVD law. Because of those responsibilities, it possesses the technical capabilities to analyze and assess the impact of foreign subsidies on U.S. domestic and foreign commerce. Commerce's legal expertise and administrative experience in this area also enable it to render effective assistance to U.S. exporters who may become subject to a CVD investigation by foreign authorities. USTR's role is to coordinate the development and implementation of overall U.S. trade policy with respect to subsidy matters, provide lead representation of the United States in the WTO (including its Subsidies Committee), and chair the interagency process on matters of policy. USTR's management of all dispute settlement litigation in the WTO and its interaction with other agencies, both federal and sub-federal, and with the private sector with respect to a broad range of subsidy issues provide it with the perspective and insight needed to ensure that U.S. policies and actions reflect the careful balance of U.S. interests in the subsidies area.

With the enactment of the Uruguay Round Agreements Act (URAA) in 1994, the two agencies' roles were further articulated and mutually reinforced in order to strengthen the enforcement of U.S. multilateral rights with respect to subsidies that harm the interests of U.S. firms and workers. Among the joint responsibilities assigned to USTR and Commerce, as set forth in section 281(f)(4) of the URAA, is the submission of an annual report to the Congress describing the Administration's monitoring and enforcement activities throughout the previous year. This report constitutes the sixth annual report to be transmitted to the Congress pursuant to this provision.

## **MONITORING AND ENFORCEMENT ACTIVITIES**

The Subsidies Agreement establishes multilateral disciplines on subsidies and provides mechanisms for challenging government programs that violate these disciplines. In addition to setting forth rules and procedures to govern the application of CVD measures by WTO Members with respect to injurious, subsidized imports, the Subsidies Agreement also contains disciplines to address the impact of subsidies on trade in foreign markets. These disciplines are enforceable through binding dispute settlement, which specifies strict time lines for bringing an offending practice into conformity with the pertinent obligation. The remedies in such circumstances can include the withdrawal or modification of a subsidy program, or the elimination of the subsidy's adverse effects.

The Agreement nominally divides subsidy practices among three classes: prohibited (red light) subsidies; permitted yet actionable (yellow light) subsidies; and permitted, non-actionable (green light) subsidies. Export subsidies and import substitution subsidies are prohibited. All other subsidies are permitted, yet are also actionable (through CVD or dispute settlement action) if they are (i) “specific”, *i.e.*, limited to a firm, industry or group thereof within the territory of a WTO Member and (ii) found to cause adverse trade effects, such as material injury to a domestic industry or serious prejudice to the trade interests of another WTO Member. Although originally three kinds of government assistance qualified as non-actionable, at present the only non-actionable subsidies are those which are not specific, as defined above.<sup>1</sup>

On the basis of these categories of discipline, the Subsidies Agreement provides remedies for subsidies affecting competition in one’s domestic market, in the market of the subsidizing government and in third country markets. These disciplines serve as a meaningful complement to the U.S. CVD law which is limited to addressing the effects of foreign subsidized competition in the United States. Although the procedures and remedies are different, the Subsidies Agreement provides an alternative tool to address distortive foreign subsidies that affect U.S. businesses and workers in an increasingly global marketplace. Within Commerce, these activities are carried out by the Subsidies Enforcement Office.

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<sup>1</sup> Prior to 2000, Article 8 of the Agreement provided that certain limited kinds of government assistance granted for industrial research and development (R&D), regional development, or environmental compliance purposes would also be treated as a non-actionable subsidy so long as such assistance conformed to the applicable terms and conditions set forth in Article 8. In addition, Article 6.1 of the Agreement provided that certain other subsidies, referred to as dark amber subsidies, could be presumed to cause serious prejudice. These were: (i) subsidies to cover an industry’s operating losses; (ii) repeated subsidies to cover a firm’s operating losses; (iii) the direct forgiveness of debt (including grants for debt repayment); and (iv) when the *ad valorem* subsidization of a product exceeds five percent. If such subsidies were challenged on the basis of these dark amber provisions in a WTO dispute settlement proceeding, the subsidizing government would have the burden of showing that serious prejudice had *not* resulted from the subsidy. However, as explained in last year’s report, a mandatory review was conducted in 1999 under Article 31 of the Agreement to determine whether to extend the application of these provisions beyond December 31 of that year. Because a consensus could not be reached among WTO Members on whether or the terms by which these provisions might be extended beyond their five-year period of provisional application, they expired on January 1, 2000.

Pursuant to section 282(c)(5) of the URAA, USTR submitted a report to the Congress on June 30, 2000, identifying the provisions of U.S. law which were enacted to implement these particular green light and dark amber provisions and which “should be repealed or modified” due to the lack of a decision by the Subsidies Committee to extend their application beyond 1999. This report is available for review at: <http://www.ustr.gov/wto/goodsub.shtml>. As set forth in section 251 of the URAA, the green light provisions of U.S. CVD law corresponding to Article 8 of the Agreement automatically expired on July 1, 2000, in light of the fact that the provisions of Article 8 no longer had force.

In 2000, the monitoring and enforcement activities of USTR and Commerce fell into the following categories: (A) pursuing and defending U.S. interests in the WTO, including in the ongoing work of the Subsidies Committee and the review of implementation by the General Council; (B) counseling the U.S. private sector and relevant government agencies about WTO subsidy disciplines; (C) monitoring foreign subsidy practices and activities, including foreign government support to the steel, iron ore, cattle/beef and film production industries and completing installation of the subsidies enforcement library; and (D) taking action to enforce U.S. rights and protect U.S. interests, ranging from WTO dispute settlement to formal and informal advocacy to assist U.S. firms, farmers and workers.

## **A. Activities in the WTO**

Apart from individual WTO disputes, discussed more fully in section D below, the WTO's focus in 2000 on general subsidies issues involved primarily work in two bodies: the Committee on Subsidies and Countervailing Measures and the General Council.<sup>2</sup> In the Subsidies Committee, work continued on various matters relating to implementation of the Agreement. At the same time, in the General Council, the Subsidies Agreement featured prominently in the broader consideration of implementation issues affecting existing WTO Agreements. In both fora, the United States' primary goal continued to be full and timely adherence by WTO Members with their subsidy obligations. However, in each setting, we also strove to work pragmatically to resolve legitimate implementation problems and to seek ways to lessen the burden of meeting obligations without diminishing their substance. Further information on the work undertaken in both bodies is detailed below.

### **1. *WTO Subsidies Committee***

In 2000, the Committee on Subsidies and Countervailing Measures continued its work across a full range of implementation-related activities, such as reviewing and clarifying the consistency of WTO Members' domestic laws, regulations and actions with Agreement requirements. The Committee continued to accord special attention to the matter of general subsidy notifications and the process by which such notifications are made to and considered by the Subsidies Committee. In this regard, at its regular meeting in May 2000, the Committee decided to take several actions to address the poor and declining state of compliance with subsidy notification obligations, including deciding

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<sup>2</sup> The WTO Committee on Agriculture also devoted considerable attention to the matter of agricultural subsidies last year in the course of both its ongoing review of implementation of reduction commitments made in the Uruguay Round and its special sessions in which negotiations are under way to increase disciplines on trade-distorting domestic supports and export subsidies. Among the leading developments in these negotiations was the tabling of the initial U.S. negotiating proposal, calling for the elimination of agricultural export subsidies and the strengthening of rules governing trade-distorting domestic support measures.

to revive its Working Party on Subsidy Notifications in an effort to find a long-term solution to the problem. The Committee also pursued its ongoing review of Members' notifications of CVD laws and actions, had an exchange of views on whether to conduct a more in-depth analysis and discussion of subsidies to the fisheries sector, concluded (as noted above) its mandated review of the operation of Article 27.5/27.6 of the Agreement, and selected a new member for its Permanent Group of Experts.<sup>3</sup>

#### **a. Review of Subsidy Notifications**

Subsidy notification and surveillance is one means by which the Subsidies Committee and its Members seek to ensure adherence to the disciplines of the Agreement. In some instances, notification is mandatory, while in others it is an optional feature that can be used to secure a benefit provided by the Agreement – such as to make use of transition periods during which a Member would come into conformity with Agreement norms. In keeping with the objectives and directives expressed in the URAA, and as illustrated by the description in this year's report of the completion of the SEO's Electronic Subsidies Enforcement Library, WTO subsidy notifications also play an important role in the United States' monitoring and enforcement activities to protect U.S. rights and benefits under the Subsidies Agreement.

Under Article 25.2 of the Agreement, Members are required to report certain information on all measures, practices and activities that, as set forth in Articles 1 and 2 of the Agreement, meet the definition of a subsidy and are specific within the territory of a Member. "New and full" notifications are submitted every third year, whereas updating notifications (usually containing information solely on changes made to previously notified subsidies) are submitted in the intervening years. Article 26 of the Agreement charges the Committee with reviewing the full notifications at special sessions held every third year, whereas updates are reviewed at regular, semi-annual Committee meetings.

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<sup>3</sup> Article 24 of the Agreement directs the Committee to establish a Permanent Group of Experts (PGE), "composed of five independent persons, highly qualified in the fields of subsidies and trade relations." The Agreement articulates three possible roles for the PGE: (i) to provide, at the request of a dispute settlement panel, a binding ruling on whether a particular practice brought before that panel constitutes a prohibited subsidy, within the meaning of Article 3 of the Agreement; (ii) to provide, at the request of the Committee, an advisory opinion on the existence and nature of any subsidy; and (iii) to provide, at the request of a WTO Member, a "confidential" advisory opinion on the nature of any subsidy proposed to be introduced or currently maintained by that Member. (To date, the PGE has not yet been called upon to perform any of the aforementioned duties.) Article 24 further provides for the Committee to elect the experts to the PGE, with one of the five experts being replaced every year. At its May 2000 meeting, the Committee chose Mr. Hyung-Jin Kim, nominated by Korea, to replace Canadian member, Robert Martin, whose term of office had expired earlier in the spring. Another PGE member, Mr. A. V. Ganesan of India, resigned his membership, effective May 18, 2000, prior to the end of his term. Consultations are ongoing regarding whom should replace Mr. Ganesan. Other Members of the PGE include Mr. Marco Bronckers (Netherlands), Mr. Gary Horlick (United States) and Professor R.G. Flores Junior (Brazil).

In 2000, at its two regular meetings, the Committee continued its examination of new and full notifications submitted for 1998, as well as updating notifications submitted for 1997, 1999 and 2000. In the table which follows, we show the 23 Members (counting the European Union (EU) and its 15 member states as one) whose notifications were reviewed by the Subsidies Committee last year, indicating the annual reporting period to which the reviewed notifications relate.

#### **WTO SUBSIDY NOTIFICATIONS REVIEWED IN 2000**

<b>WTO MEMBER</b>	<b>1997 Update Notification</b>	<b>1998 Full Notification</b>	<b>1999 Update Notification</b>	<b>2000 Update Notification</b>
AUSTRALIA			X	
BAHRAIN			X	X
BOLIVIA		X	X	
CANADA			X	
CHILE			X	X
COSTA RICA			X	X
CYPRUS		X		
CZECH REPUBLIC	X			
EU (incl. 15 member states)			X (Partial)	X (Partial)
HONG KONG, CHINA				X
JORDAN			X	X
KOREA				X
LATVIA			X	
LIECHTENSTEIN				X
MACAU, CHINA		X	X	X
NORWAY		X (Supplement)	X	X
POLAND			X	
SINGAPORE				X
SLOVENIA			X	X
SWITZERLAND				X
TURKEY			X	
UNITED ARAB EMIRATES		X	X	X
URUGUAY			X	X



As of January 1, 2001, when membership in the WTO had reached 140, only 49 Members had submitted new and full subsidy notifications for the 1998 reporting period, while 35 and 25 Members, respectively, had submitted updating notifications for the 1999 and 2000 periods.<sup>4</sup> Notably, 44 Members have never made a subsidy notification to the WTO, although three of these acceded to the WTO only in the fourth quarter of 2000 and none account for a significant share of world trade.

In view of the ongoing difficulties experienced by Members, including the United States<sup>5</sup>, in meeting the Agreement's subsidy notification obligations, the Committee took several actions in 2000 aimed at improving the situation. First, it urged that any Member having outstanding subsidy notifications should take the steps needed to come into compliance with its obligations as soon as possible before the end of 2000. Second, it suggested that Members with more than one notification outstanding could make a single "best efforts" notification covering all the preceding time periods for which a notification was due, placing the greatest emphasis on supplying information in relation to the most recent periods. Third, it reconvened the Working Party on Subsidy Notifications to take a fresh look at the notification problems confronting Members and develop possible long-term solutions for the Committee's consideration. The Working Party met on the margins of the regular fall Subsidies Committee meeting and, as initial steps: (i) authorized the Secretariat to circulate a questionnaire to Members inquiring about the specific problems they face in making notifications, and (ii) requested the Chairperson to pursue direct contact with individual Members that have not yet made a notification. On the basis of these steps and the information gathered in response, the Working Party will continue to consider whether there are actions that the Committee could take or recommend to register improvements in this area.

#### **b. Other Activities of the Committee**

Throughout the year, WTO Members continued to submit notifications of new or amended CVD legislation and regulations and of CVD investigations initiated and decisions taken. These notifications were reviewed and discussed by the Committee at both of its regular meetings. In reviewing notified CVD legislation and regulations, the Committee procedures provide for the exchange in advance of written questions and

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<sup>4</sup> In this sentence, the notifications of the EU and its 15 member states are counted as a single Member's notification in each of the reporting periods, although the updating notifications for 1999 and 2000 did not contain information on all 15 EU member states.

<sup>5</sup> As of this writing, the United States is continuing its efforts to finalize a consolidated updating notification for the 1999 and 2000 reporting periods. Beyond updating information on federal programs, the need to update and expand upon more than 200 individual measures reported at the sub-federal level in our previous notification is one of the reasons for this delay.

answers in order to clarify the operation of the notified measures and their relationship to the obligations of the Agreement. The United States continued to take a leading role in the Committee's examination of the operation of other Members' CVD laws and their consistency with the obligations of the Agreement.

To date, 51 Members of the WTO (counting the EU as one) have notified that they currently have CVD legislation in place, while 32 Members have notified that they maintain no such legislation. Among the notifications of CVD laws and regulations reviewed in 2000 were those of Argentina, Australia, Chile, Estonia, India, Kyrgyz Republic, Malaysia, Thailand and Turkey, while certain previously notified and reviewed legislation of both the EU and the United States continued to be the subject of exchanged questions and answers. As for CVD measures, seven WTO Members notified CVD actions taken during the latter half of 1999, whereas seven Members also notified actions taken in the first half of 2000. The Committee reviewed actions taken by Australia, Canada, Chile, the EU, Egypt, South Africa and the United States.

Among other matters, at its May 2000 meeting, the Committee had an exchange of views on the issue of trade-distorting and environmentally harmful subsidies to the fisheries sector, initiated at the request of Iceland in reaction to responses submitted by the EU on its 1999 updating subsidies notification. (As noted in last year's report, the United States, Iceland and a number of other WTO Members had proposed that negotiations in this area be endorsed or initiated at the WTO's 1999 Ministerial Conference in Seattle.) Iceland, supported by the United States and some other Members, suggested that the Committee take up as an ongoing agenda item consideration of the fisheries subsidies issue, with a focus on the technical and legal dimensions of the issue (as distinct from the "political" context which, Iceland pointed out, had been the context for discussions in the Committee on Trade and the Environment). Among the options for further work, Iceland suggested that the Committee could: (i) undertake to identify fishery subsidies, including those which were trade distorting and/or a cause of overcapacity and overfishing; (ii) consider which Subsidies Agreement disciplines could apply to fishery subsidies and which may need to be clarified/strengthened in order to deal more effectively with such practices; and (iii) explore the extent to which fishery subsidies with adverse effects could be identified. Although several Members were not prepared to agree to this proposal as an ongoing Committee work program, it was acknowledged that any Member could place an item on the Committee's agenda, and a number of Members expressed interest in holding further discussions of these issues.

### **c. Areas of Focus in 2001**

In 2001, the Subsidies Committee will continue and, likely, intensify its attention to implementation issues in a variety of respects. First, as noted above, the United States will continue to work with others to try to identify ways to rationalize the burdens of subsidy notification for all WTO Members without diminishing transparency or taking away from the

other substantive benefits of the notification obligation. The next round of “new and full” notifications is due to be submitted by June 30 of this year, and the Committee will begin preparations for its review of these notifications into 2002. The United States will participate fully in this review and in seeking to increase the usefulness of notification and review procedures as a means of strengthening subsidy disciplines.

Second, the United States will continue to play a leading role in the review of other WTO Members’ CVD legislation and actions, and will bring to Members’ and the Committee’s attention any concerns which may arise about such laws or actions, whether in general or in the context of specific proceedings. As explained later in this report, U.S. exports have been the subject of several important CVD actions over the past year, and both Commerce and USTR have actively assisted U.S. agencies and exporters in responding to questionnaires and exercising their full rights of participation in these proceedings. Raising questions and concerns in the Committee provides an avenue to gather helpful information and voice formal concerns or objections.

Finally, as explained in the next section, pursuant to the directive of the General Council, the United States stands ready to participate constructively in the Committee’s examination of two referred implementation issues and to engage with others regarding other implementation priorities, consistent with the objective of sustaining and strengthening WTO subsidy disciplines. In line with these same principles, the United States is also prepared to engage in any preparatory work that the Committee may decide to begin in anticipation of possible future requests by developing country Members that the Committee approve an extension of their transition periods for the phase-out of export subsidies.

## **2. *WTO General Council***

An important feature of the General Council’s responsibilities since the outset of the WTO has been oversight of implementation of WTO Agreements. In 2000, following up in part on concerns that had been raised by various WTO Members prior to and at the third Ministerial Conference in Seattle in December 1999, the General Council agreed to conduct a special review of issues identified by Members as giving rise to implementation concerns under existing WTO Agreements. Special sessions of the Council were held in May, June, October and December, while numerous informal consultations were also held between these sessions in order to consider certain issues in greater depth and explore development of consensus-based approaches to problems. An inventory of specific concerns identified by certain developing countries prior to the Seattle Ministerial provided the benchmark for discussions, but the work was not limited to these concerns. The Council’s purpose was to increase political attention and organize improved technical support towards the resolution of implementation issues, but progress was to some degree clouded by disagreements among Members over which issues were genuine problems of implementation and whether/how best to address them.

Various issues concerning the Subsidies Agreement figured prominently in the General Council's discussions. In general, developing countries sought changes to the Agreement in an attempt at loosening disciplines applicable to them regarding the use of subsidies and lessening these countries' exposure to CVD actions. Among the specific proposals advanced by various developing countries were proposals to restore and expand non-actionable subsidy provisions to protect many of the production and export subsidies used by developing countries; to alter the rules governing export subsidies and "special and differential treatment" for developing countries in order to increase the latitude for them to use such subsidies; and to modify CVD rules by, for example, raising the levels which establish *de minimis* rates of subsidization and negligible import volumes in cases involving developing countries.

The United States engaged actively and constructively in these discussions, but was clear about its goals and expectations. We indicated our readiness to work towards practical solutions for real implementation problems, but we voiced concern over proposals which might weaken the fundamental disciplines or conflict with the core objectives of the Subsidies Agreement. In short, the United States sought to ensure a process which would separate out and stress legitimate implementation issues from those which were actually aimed at a selective alteration in the terms of the Agreement – especially where such alteration would dilute WTO rules and obligations. Therefore, the logical place to start, we argued, was for the competent technical body to take up analysis and consideration of such technical issues and proposals, without prejudice to the positions which Members might take as to the merits of such proposals. We indicated that we had our own concerns about implementation, e.g., as regards compliance with the obligation for most developing countries to have eliminated their import substitution subsidies (per Article 27.3 of the Agreement) by January 1, 2000, and progress toward the projected phase-out of export subsidies by such countries by January 1, 2003. A serious and responsible examination of such issues could only occur in the Subsidies Committee. Out of that process could emerge a number of results: (i) potential solutions to certain implementation problems; (ii) a recognition that certain problems or issues cannot be fairly or adequately addressed in an implementation context; and (iii) the identification of certain issues where there is no consensus about the existence or nature of a problem and/or a need to address it.

On December 15, 2000, the General Council formally issued a decision on implementation issues which included a mandate to the Subsidies Committee to examine certain matters "as an important part of its work".<sup>6</sup> These matters are:

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<sup>6</sup> Among its December 15 decisions, the General Council also "called upon the Director-General to take appropriate steps, in accordance with WTO usual practice, to rectify the omission of Honduras from the list of Annex VII(b) countries ... [t]aking into account the unique situation of Honduras as the only original Member of the WTO with a GNP per capita of less than US\$1000 [per annum] that was not included in Annex VII(b) to the Agreement". Annex VII to the Agreement identifies two specific groups of developing

- < all issues relating to Articles 27.5 and 27.6 of the Subsidies Agreement, including the possibility to establish export competitiveness on the basis of a period longer than two years; [and]
- < issues concerning aggregate and generalized rates of remission of import duties and of the definition of “inputs consumed in the production process,” taking into account the particular needs of developing country Members.

The first item referred for examination relates to a provision intended to provide for early discipline over certain export subsidies used by export-competitive developing countries. Article 27.5-27.6 of the Agreement provides that a developing country which has reached 3.25 percent of world trade in a given product over two consecutive years must accelerate the phase-out of its export subsidies on that product. The product scope is defined as a section heading of the Harmonized System nomenclature, and application of this provision can be triggered either by a notification made by the developing country or a computation done by the WTO Secretariat at the request of another Member. Pursuant to Article 27.6, the Subsidies Committee began reviewing the operation of this provision at the end of 1999, but decided to conclude the review at its May 2000 meeting in large part because the provision had never been invoked and there was no concrete experience by which to judge its operation. In this new examination, certain developing country Members have asked that the issue be reexamined because they believe that extending the two-year standard would facilitate development of their export competitiveness in certain product lines. When this provision had been discussed in the Committee in the past, the United States and several other Members questioned whether the current formulation was sufficient to capture situations in which developing countries were already demonstrably competitive in certain product lines.

The second item referred for examination relates to item (i) of the Illustrative List of Export Subsidies set forth in Annex I to the Agreement, and Annex II to the Agreement which contains guidelines for establishing whether and the extent to which inputs are consumed in the production of an exported product. Item (i) generally provides that a duty drawback scheme can give rise to an export subsidy in situations where the amount remitted or drawn back upon export exceeds the amount of duty paid on imported inputs used to make the exported good. To determine when a drawback is excessive, it is

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countries – the least-developed countries as designated by the United Nations and other specified WTO Members which had annual per capita GNP levels of less than \$1000 at the time that the Annex was drafted. These countries receive treatment more generous than that given to other developing countries with respect to both export subsidy obligations and the application of CVD rules. Over the past several years, a number of developing countries have raised concerns about the scope and operation of Annex VII. While there is no justification for arbitrarily expanding the scope of this Annex, in terms of either countries covered or the exceptions provided from normal Agreement rules and disciplines, some legitimate questions have been raised about the manner in which Annex VII may have operated or been interpreted. The clarification of Honduras’s inclusion is one such issue, and its omission was formally rectified on January 20, 2001.

necessary, therefore, to determine what and how imported inputs are used in the production process of the exported product. The Subsidies Agreement defines this in Annex II as “inputs physically incorporated, energy, fuels and oil used in the production process and catalysts which are consumed in the course of their use to obtain the exported product.” This standard was negotiated in the Uruguay Round, and represents an expansion from the exclusive “physically-incorporated input” standard that applied to a similar export subsidy rule in the Tokyo Round Subsidies Code. Certain developing countries have asked that this issue be taken up to consider whether duties paid on other imports associated with the production process ought also to be rebated, and to look at the documentation and verification requirements appropriate to determining compliance with the Annex II standard.

The United States appreciates the opportunity to review these and other implementation issues in the Subsidies Committee, in part because they underscore that our trading partners also recognize the need to deal directly with implementation problems where they exist. We intend to participate actively and constructively in these examinations with a view towards arriving at practical solutions to any legitimate problems which may be identified, consistent with the goal of sustaining and strengthening WTO subsidy disciplines.<sup>7</sup>

## **B. Subsidies Enforcement Counseling and Outreach**

Vigorous enforcement of the Subsidies Agreement in the advancement or protection of U.S. interests is a top priority for USTR and Commerce. The SEO’s main mission is to examine subsidy complaints and concerns raised by U.S. exporters and to monitor foreign subsidy practices to determine whether they are impeding U.S. exports and are inconsistent with the Subsidies Agreement. To this end, for the fourth year in a row, Commerce has committed additional personnel and resources to the Subsidies Enforcement Office in order to enhance its ability to reach out to and assist the private

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<sup>7</sup> We are also prepared to engage in any preparatory work that the Committee may decide to begin in anticipation of possible future requests by developing country Members that the Committee approve an extension of their transition periods for the phase-out of export subsidies. Article 27.2 of the Subsidies Agreement in general gives developing country Members an additional eight years from the date of entry into force of the Agreement (*i.e.*, January 1, 1995) in which they may use export subsidies. Therefore, as noted earlier, the export subsidy transition period for most developing country Members expires on January 1, 2003. Although the United States and other Members have asked certain developing countries to report on the status of their phase-out plans during the review of general subsidy notifications, little information has typically been supplied in response. Notwithstanding that Article 27.4 stipulates that individual requests for extension need not be made until January 1, 2002, the Agreement does prescribe that these subsidies are to be phased out “in a progressive manner” and within a shorter period where “the use of such . . . subsidies is inconsistent with [a country’s] development needs.” Given this, there may be grounds for the Committee to consider during the course of 2001 how it intends to take up extension requests which may be made under these provisions and/or whether there is a need for a special reporting and monitoring process to facilitate export subsidy phase-outs.

sector. Moreover, SEO staff have continued to take steps to increase the U.S. trading community's awareness of the important resources that the office has to offer. In particular, SEO personnel have continued to develop and analyze key information about subsidies, integrate other government resources into this information gathering and advocacy process, and make all of its publicly available information about foreign subsidies Internet-accessible. In addition, during 2000, the SEO staff have been engaged in several focused areas of work, having led or been involved in the preparation of several studies and reports on subsidy practices in various countries affecting specific industries in the United States. An overview of all of these efforts is provided below.

## **1. *Enforcement Counseling***

On a regular basis, USTR and Commerce SEO staff handle inquiries and meet with representatives of U.S. industries who are concerned with the subsidization of foreign competitors. As a result of this counseling, we are currently working with various U.S. industries to resolve questions and concerns about certain foreign subsidy practices, including, if appropriate, the development of potential WTO subsidy dispute settlement cases.

The type of information provided by U.S. companies to the agencies through these contacts varies greatly. In many instances, the first contact that a U.S. exporter makes with government officials regarding a subsidy problem is by phone or letter. Initially, we provide an overview of the Subsidies Agreement and explain U.S. rights under this Agreement. We then discuss in detail the subsidy problem the exporter confronts and gather as much information as possible about the subsidy practice and how it has affected the exporter's ability to sell in the U.S. or foreign markets. Following this, we determine what further information is needed and the best way to go about collecting it. Typically, the firm or industry in question is itself the best source of information concerning the harm resulting from the subsidization. This information is critical to support a claim of "serious prejudice," which is normally the most useful injury standard available in a WTO subsidy enforcement proceeding.<sup>8</sup> While the U.S. exporter is assembling such serious prejudice information, SEO staff begin the process of researching the subsidy practice at issue to

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<sup>8</sup> As explained earlier, in order for subsidies to be actionable, other than prohibited subsidies, they must be specific (e.g., provided to a single firm or industry or a group thereof) and cause adverse effects to the interests of another Member. Adverse trade effects can include (1) material injury to the domestic industry, or the threat thereof, as in CVD proceedings, (2) the nullification or impairment of benefits accruing directly or indirectly to another WTO Member under the GATT 1994, and (3) the displacement or impeding of sales or significant price undercutting, price suppression or price depression in so-called "serious prejudice" disputes brought to the WTO. Because serious prejudice can arise in any market affected by an actionable subsidy (whether in an importing country, the subsidizing country, or a third-country market), it is the standard most often used to challenge subsidized competition in the subsidizing country or third-country markets.

determine the legal framework under which the foreign government is offering the assistance and whether other U.S. exporters have been facing similar problems.

In order to develop as much information as possible about the subsidy practice, we draw on the following resources: reviewing information contained in the SEO Electronic Subsidies Library, researching Internet sites, discussing the issue with Commerce offices that routinely collect information on specific country and industry practices, and contacting Commerce's Advocacy Center<sup>9</sup> to learn whether any U.S. exporters have reported facing similar problems. After this initial research, we then contact the U.S. embassy in the appropriate foreign country to discuss our findings and determine whether there is further information that could be provided. Our counterparts in foreign governments also may be contacted to ascertain whether they have had complaints from their exporters about the same subsidy practice in a third country.

Once sufficient, relevant information has been gathered to permit the matter to be reliably evaluated, USTR and Commerce will confer with an interagency team to determine the most effective way to proceed. Where appropriate, we may also seek public comment and/or consult with representatives of U.S. state and local governments. In many cases, raising the matter with the foreign government authorities through informal contacts, formal bilateral meetings and/or in the WTO Subsidies Committee discussions can promote more speedy and practical solutions than resorting to WTO dispute settlement. These other approaches also may permit us to uncover additional information or to improve our understanding of the practice, which can affect the decision concerning the appropriate next steps to take, including the possibility of pursuing the problem on grounds other than those provided for under WTO subsidy rules. We have found that it is frequently advantageous to pursue resolution of these problems through a combination of informal and formal contacts, including, where warranted, dispute settlement action in the WTO.

## **2. *Integration of Government Resources***

One of the most important aspects of increasing the effectiveness of the SEO and subsidy enforcement generally is to ensure that government personnel who have daily contact with the U.S. exporting community, both in the United States and abroad, are aware of the resources and services available regarding subsidy enforcement efforts. Within Commerce, it is the responsibility of the U.S. Commercial Service (USCS) to counsel U.S. companies both here and abroad. Therefore, formal briefings are held with USCS officers when they are in Washington to explain to them the type of information and services available through the SEO. In addition to providing the officers with an explanation of SEO activities, informational handouts are provided to take back to their posts to inform other USCS officers and U.S. business visitors to the post about resources

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<sup>9</sup> The Advocacy Center helps U.S. exporters seek contracts abroad on an equal footing with foreign government-backed competitors.



available through the SEO. (See Attachment 1.) These briefings also have become a source of information concerning the types of subsidy problems U.S. companies are facing in the host countries of the USCS officers.

SEO personnel also have participated in special conferences held for senior commercial officers and training sessions held for foreign service national employees<sup>10</sup> in Washington. These meetings offer a unique opportunity to provide information on the resources available through the SEO to a large number of government officials who have daily interaction with U.S. companies.

As part of the strategy to involve U.S. government personnel overseas in subsidy enforcement activities, SEO staff work with officials at the Department of State to include foreign service economic officers in this effort, pursuant to the statutory mandate to secure the cooperation of other federal agencies as provided for in section 281(g) of the URAA. Collaboration between the Departments in developing and sharing information concerning foreign government subsidy practices and the administration of foreign governments' unfair trade laws<sup>10</sup> is an important aspect of this effort. To this end, and as explained further below, USTR and SEO personnel have been training State Department economic officers in identifying and evaluating foreign subsidy practices and in monitoring unfair trade actions involving U.S. companies. State Department economic officers then provide relevant information to Commerce, USTR and the interagency team on a regular basis.

To reinforce the priority the Administration attaches to effective enforcement, SEO staff met with foreign service officers at a number of U.S. embassies and consulates in 2000. During these meetings, we provided both USCS and economic officers with information on WTO subsidies disciplines and the resources available through the SEO. The USCS and economic officers each provide a unique perspective to the subsidy enforcement efforts. The USCS officers have daily contact with the U.S. exporting community and, therefore, are directly aware of the problems facing the companies. The economic officers are informed about the types of subsidy programs being administered, implemented or contemplated by the host governments. Both types of information are critical for the SEO to be effective. The information gathered has proven to be very useful

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<sup>10</sup> Foreign service nationals are professional employees of U.S. embassies and consulates who are natives of the country in which the embassies are located. These employees assist foreign service and USCS officers with their assigned duties.

<sup>10</sup> An important factor in a U.S. company's ability to do business in any given market is the manner by which the foreign government administers its unfair trade laws and, in particular, its CVD and antidumping (AD) laws. Import Administration monitors these foreign AD and CVD actions involving U.S. companies to ensure that the countries are conducting these investigations in accordance with their international obligations. See section D of this report for a more detailed description of the assistance which Commerce and USTR have recently rendered to U.S. exporters in several foreign CVD cases involving U.S. exports.

in determining the most appropriate areas in which to focus our efforts to assist U.S. exporters. SEO staff will be maintaining and extending these contacts and outreach efforts throughout 2001. In this regard, we note that as part of the fiscal year 2001 budget, Congress provided additional funding to support a trade compliance and market access initiative, establishing an interagency overseas compliance program. With these funds, additional personnel will be placed in posts abroad to enhance the effectiveness of U.S. monitoring and compliance of trade agreements, including the Subsidies Agreement.

Finally, SEO personnel have been working very closely with other offices within Commerce's International Trade Administration (ITA) to ensure that they are fully aware of our subsidy enforcement efforts and that the SEO is familiar with the information on subsidies that these offices routinely collect in the course of their own work. Chief among these contacts are the country- and industry-specific desk officers, the Advocacy Center, the Trade Compliance Center (TCC) and the Compliance Coordinators group. The Compliance Coordinators group is comprised of representatives from all of ITA's units (Market Access and Compliance, Trade Development, Import Administration, and USCS) and the Patent and Trademark Office, and serves as the central coordinating point for ITA's market access and agreement compliance activities. The group meets regularly to share information on trade compliance and market access issues that may be common across regions or industrial sectors, and works to resolve these issues by drawing upon the full range of expertise available within ITA.

Our work with the TCC and the Advocacy Center provides good examples of the collaborative effort within ITA. The TCC monitors compliance with active international agreements covering manufactured goods and services to which the United States is a signatory. Complaints received by the TCC that may involve foreign subsidies are immediately referred to the SEO for analysis and action. The Advocacy Center assists U.S. exporters seeking government contracts abroad by providing U.S. government advocacy on behalf of the U.S. company when foreign competitors bidding on the same contract enjoy support from their governments. At times, this foreign government support may be in the form of subsidies. When the Advocacy Center receives a call from a U.S. company concerning possible foreign government subsidization, the Center contacts the SEO and provides all of the relevant information. In addition, the Advocacy Center has connected the SEO to its computer database. This allows us to review information gathered by the Center to determine whether U.S. exporters' access to foreign contracts is being impeded by government practices which may be actionable under subsidy rules.

### **C. Monitoring Foreign Subsidy Practices**

As mentioned above, one of the primary missions of the SEO is to monitor subsidy practices worldwide. In addition to monitoring activities from Washington, SEO staff trained personnel in U.S. diplomatic posts overseas to identify potential subsidies that

could lead to unfair trade. During this past year, SEO staff traveled to several countries to coordinate our monitoring efforts with USCS officers and State Department economic officers and to provide an overview of the Subsidies Agreement, applicable U.S. trade laws and practical information that could be used to monitor government practices and determine whether they may constitute actionable subsidies. SEO staff also examined the resources available at the posts and evaluated all collected information regarding potential subsidies, as well as establishing regular reporting mechanisms with the posts.

The SEO has continued its efforts to develop a comprehensive database of foreign government practices that are potentially actionable under the Subsidies Agreement. As mentioned in last year's report, the SEO has been focusing its efforts on making this information available through the Internet. By making this information available at a single site, U.S. exporters are able to learn quickly about the remedies available to them under the Subsidies Agreement and the information necessary to develop a CVD case or a WTO subsidies complaint. In addition, by integrating all of the subsidy information developed through years of conducting CVD investigations, the information is now available in a format which USTR and Commerce can easily use to check the WTO notifications of other countries and ensure that they are complete and accurate. As discussed in section A of this report, the notification process is an important aspect of our subsidy enforcement efforts.

This year, we are pleased to report that the electronic subsidies database has been completed. The completion of the database is the culmination of three years of intensive efforts by SEO staff reviewing hundreds of countervailing duty cases, summarizing government practices investigated and linking these summaries directly into the Federal Register notices, where they are further discussed. The redesigned site, which can be found at <http://ia.ita.doc.gov/esel/eselframes.html>, now includes information on all the foreign subsidy programs that have been investigated in U.S. CVD cases since 1980, covering more than 50 countries and over 2,000 government practices. It will be updated at least quarterly, or more often as resources permit, to reflect programs investigated or reviewed in on-going CVD cases in order to keep the site current. Attachment 2 shows the layout of the library and includes the list of U.S. trading partners about which information is available on the site.

In addition to the information discussed above, the Import Administration and Subsidies Enforcement sites also provide all derestricted WTO subsidy notifications, listed by country, and easily accessible links to other useful U.S. and foreign government sites, such as USTR, the U.S. Ex-Im Bank, the IMF, the WTO (which maintains databases of Members' CVD actions as well as their subsidy notifications to the WTO), the Canadian and Mexican government trade agencies, and NAFTA. The SEO will be working over the coming year to increase the number of U.S. government and foreign links provided. In addition, links to Commerce personnel who can provide additional guidance are supplied. The Internet provides an easy and efficient avenue to reach U.S. businesses and other

interested parties in order to furnish them with information previously available only in person in Washington.

Another aspect of our monitoring activity is the tracking of numerous trade journals and the news and business sources of our major trading partners. On a daily basis, SEO personnel monitor cable traffic, Foreign Broadcast Information Service (FBIS) reports, trade journals and more than 35 news and business sources from various countries. Weekly summaries of subsidy-related articles are compiled for Asia, the Pacific, Europe and the Americas.

These summaries allow us to continually monitor activities in various areas of the world and to share timely information on specific subsidy issues with other U.S. government offices or concerned industry representatives and other members of the public. Through this process, we have been able to identify a number of areas where subsidies may have been or will be provided by governments to spur production or exports. As discussed above, once such subsidy practices are discovered, Commerce and USTR pursue resolution of these issues through a combination of informal and formal contacts, including, where warranted and following interagency review and deliberation, dispute settlement action in the WTO.

Finally, during 2000, SEO staff have been engaged in several focused areas of work, having led or been involved in the preparation of several studies and reports on subsidy practices in various countries affecting specific industries in the United States. An overview of these efforts is provided below.

## ***1. Report to the President on Global Steel Trade***

A major focus of subsidies enforcement activity during this past year has been our continued response to the 1998 steel crisis. As discussed in last year's report, the U.S. steel industry has experienced severe import competition since 1997 from several countries that aggressively targeted the strong U.S. market. The U.S. government responded quickly to the crisis, taking vigorous and forceful action to try to ensure that the U.S. steel industry and American steelworkers were not harmed by a flood of unfairly traded steel imports. One aspect of the government's response to this crisis was increased identification and surveillance of foreign subsidy and market distorting practices that may exacerbate trade frictions.

A key component of the Steel Action Program, announced in August 1999, was an examination of subsidies and market distorting trade barriers for steel and steel inputs in the major steel producing countries of Japan, Russia, Korea and Brazil, as well as countries that did not play a large part in the 1998 crisis, but may be of future concern, *i.e.*, China, India and Ukraine. The SEO played a central role in conducting this extensive examination, and many additional personnel were temporarily added to this project to

undertake this tremendous task. The report, released in July 2000, was the product of an intensive 10-month study looking into every major aspect of the steel crisis. The teams analyzed relevant economic data and consulted with U.S. steel producers, workers, and unions; foreign steel producers and their workers; foreign government and embassy officials; trading companies, steel service centers, and other steel consumers; and a wide array of industry experts.

The report illustrates how devastating the 1998 crisis was. In the latter half of 1998, the United States faced an unexpected surge in steel imports. Steel imports in 1998 rose dramatically, up 33 percent compared to 1997, previously the record year for steel imports. Average prices for steel products in the United States declined dramatically due to a 20 percent reduction in the price of imports in 1998. U.S. steel plants, which were operating at over 90 percent capacity in the first half of 1998, slowed to 75 percent by year-end. Ultimately, this surge in imports resulted in six U.S. companies going bankrupt and more than 6,600 steel workers losing their jobs.

The report attributes the causes of the 1998 steel crisis to a number of factors, including overcapacity in the world steel market, the Asian financial crisis, significant depreciation of certain currencies and long-term structural factors, *e.g.*, government assistance, impediments to importing, noncompetitive market structures and unsound banking practices. The crisis was triggered by economic downturns abroad. The Asian financial crisis began with Thailand in mid-1997, and spread throughout Asia, bringing with it the worst economic downturn to hit the region in thirty years. As economies collapsed, demand for steel in Asia quickly dried up. Asian steel producers and traditional exporters to the region, such as Russia and Brazil, needed to find other markets and turned to the United States and Europe, where demand was strong. The situation was further exacerbated as the Asian financial crisis went global, spreading to Russia and Brazil by mid-1998.

One would have expected U.S. imports to increase as a result of these developments. Few, however, anticipated the magnitude of the increase in imports that took place in 1998. A large amount of steel was diverted to the United States from other markets. The largest increases came from Japan, Korea and Russia. Imports from these three countries alone accounted for 76 percent of the increase in total U.S. steel imports. However, the 1998 steel crisis was not simply one of increased volumes. Imported steel was coming in at extremely low prices in many instances, assisted by the declining value of foreign currencies that buoyed dollar-denominated export revenue in home currency units.

Because of the importance of the steel industry in many national economies, the marked tendency among all countries during an economic downturn or crisis is to preserve productive capacity in the hopes of saving jobs and maintaining economic stability and, thereby, forestalling adjustments mandated by the market. Market-distorting practices can spill over into the global marketplace during cyclical downturns by helping steel companies

maintain or increase market share and productive capacity via the exporting of low priced steel. Such practices enabled the steel companies in the countries most involved in the 1998 crisis to set low prices for exports and avert downsizing adjustments dictated by the market. It should be noted that the steel report examined a wide-range of trade barriers, not all of which are subsidies.

**Japan.** Lax enforcement of antitrust laws is the primary market-distorting trade practice in Japan affecting the steel. Many steel industry experts note that a “cooperative system” exists among the major steel producers in Japan. Apparent coordination on production and other matters helps allow Japanese steel companies to charge high prices for their products in Japan. Because domestic supply needs to be controlled for such a system to work, import barriers are kept in place to keep import volumes to a minimum. Revenues from high priced home market sales can be used to sustain low priced exports, which give rise to concerns of unfair trade.

**Russia.** The report explains that perhaps the most significant long-term factor leading to the 1998 steel crisis has been the emergence of Russia as one of the world's top steel exporters. In the period before the crisis, the Russian steel industry was caught between two systems. A large steelmaking capacity built in Soviet times to meet domestic needs faced a domestic market in which demand had collapsed. Privatized companies continued to do business by bartering their products, often not paying their workers, suppliers or taxes, knowing that bankruptcy procedures rarely resulted in the closure of a company. In addition, state-controlled input suppliers continued the old command economy tradition of providing low priced inputs and transport to the steel industry. In this environment, there was a tendency for more steel to be produced than demand would otherwise dictate and for steel to be sold at prices not necessarily related to the cost of production. As a result, Russia experienced trade frictions with a number of countries, of which the United States is only the latest example.

**Korea.** The report illustrates that the financial difficulties of the Korean steel industry as a whole in the 1990s can be linked to excessive borrowing to fund over-investment in under-performing capacity. Massive new investments in steel during the 1990s were encouraged by unsound, often government-influenced, bank lending practices. A number of nonviable companies, which accounted for almost a quarter of domestic capacity, were kept in operation before and during the crisis, and continued to produce for domestic and export markets. The government also supported the development of Korea's largest steel producer – Pohang Iron and Steel Company (POSCO) – to the point that it has achieved a monopolistic position in the Korean steel market. As a government-owned company, POSCO was used by policymakers to further the government's industrial development objectives, which included providing low-cost steel to downstream producers. Additionally, POSCO's dominant position raises fundamental concerns about competition within the Korean steel market and possible trade effects that POSCO's continued dominance may have in the future.

**Brazil.** The report describes how the Brazilian steel industry, like Japan's steel industry, enjoys the advantages of a domestic market insulated from real market competition. In one instance, Brazilian antitrust authorities found evidence of cooperative pricing practices among Brazilian steel producers. These practices, in combination with extensive cross-ownership among Brazilian steel producers and various import barriers, reduce domestic competition and create conditions for producers to charge higher prices at home, the revenues from which can be used to sustain low priced exports.

**New Players: China, Ukraine and India.** The report also looks at countries that did not play a large part in the 1998 crisis, but may play a significant role in global steel trade in the future. Although **China** is the world's largest steel producing nation, it faces problems exporting due to the low quality of its steel. Nevertheless, we will watch developments in the Chinese steel industry closely given the Chinese government's commitment to steel as a strategic industry. **Ukraine** is a significant producer of steel, currently exporting 60 percent of its finished steel output and with an even greater export potential. The Ukrainian government's continued involvement in most of Ukraine's steel companies raises a significant concern about the potential for unfairly traded steel in international markets. **India's** near-term export potential is substantial. The decline in domestic demand and active encouragement by the government has prompted Indian steel producers to turn increasingly to exports. As with Ukraine, there is concern about the possibility for unfairly traded exports because of extensive government involvement with Indian producers.

The report notes that certain of the traditional steel-supplying countries have recently taken some steps to address these structural problems. However, most of the problems still remain and may contribute to unfair trade in steel products in the future, much as they have in the past. The report concludes with recommendations on the most effective means to address the subsidies and market-distorting trade barriers. These recommendations include steps to address instability in the global steel markets, such as focused bilateral engagement with the major countries involved; faster relief for industries, workers and communities when import surges occur; early warning of import surges and of changes in industry conditions; and reinvigorating the international steel policy agenda. The steel industry continues to suffer from strong import competition and we will continue to vigorously enforce the trade laws to help ensure that this competition is fair. The full report, *Report to the President on Global Steel Trade*, is available on the ITA home page at [http://www.ita.doc.gov/media/x\\_newfram.html](http://www.ita.doc.gov/media/x_newfram.html).

## **2. Study of the Iron Ore Industry in Brazil**

The July 2000 steel report also announced that the SEO would conduct a study of subsidies received by the Brazilian iron ore and slab steel industries. This study was recommended because of U.S. iron ore producers' increasing concern about surges in

imports of Brazilian low priced slab steel and, to a lesser extent, iron ore. U.S. industry officials believe that the Brazilian government has subsidized its iron ore and slab steel producers, enabling them to sell their merchandise in the United States at low prices, unfairly displacing U.S. iron ore production. The SEO has begun its study of the iron ore and slab industries in Brazil and their impact on the U.S. industry, focusing on several areas of government involvement in these sectors.

The condition of the U.S. iron ore industry has deteriorated over the last few years. Most of the United States' iron ore reserves are in the form of low-grade taconite found in northeastern Minnesota's Iron Range. In 1999, Minnesota's seven producers employed 5,760 workers, down from 5,976 in 1998 and 90,000 in 1950. Current capacity is 48 million metric tons (MT); however, only 43.2 million MT were produced in 1999. Since the vast majority of U.S. iron production is centered in communities in Minnesota where the mines are the largest employer, closing a mine or slowing of production not only affects the mines' employees, but has an exponential effect on the surrounding areas. Currently, the U.S. industry is facing even more cutbacks. LTV Steel Company's Hoyt Lakes mine and taconite plant closed in January 2001, resulting in the loss of another 1,400 jobs and over 8 million tons of capacity. USX Corporation has shut down one of its iron ore production lines in Minnesota, accounting for 12 percent of its annual output. In addition, Hibbing Taconite Company closed temporarily at the end of January for six weeks and will shut down for an additional four weeks this summer.

A surge in imports of low priced slab steel from Brazil<sup>11</sup> has exacerbated the situation faced by the U.S. iron ore industry. Between 1998 and 1999, imports of Brazilian slab increased 73 percent and have remained at this level throughout 2000. Published reports indicate that Brazilian iron ore and steel producers are planning to increase the production of slab in the near future, most of which will be targeted at the U.S. market, further threatening the viability of the U.S. iron ore producers. For example, Brazil's largest steel maker, Companhia Siderurgica Nacional, recently reported that it was planning to build by 2003/2004 a \$2 billion steel mill producing four to six million tons of slab per year for export to the United States.<sup>12</sup> In addition, CVRD, the world's largest iron ore producer, has announced plans to create a joint venture with a Colombian investor to build a steel mill in either Colombia or Trinidad and Tobago to produce slab steel for export to the United States.<sup>13</sup>

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<sup>11</sup> One ton of imported slab displaces the demand for 1.5 tons of U.S. iron ore in the steel making process.

<sup>12</sup> *American Metal Market*, "CSN Seeking \$1Billion for Slab, Rolling Mills," January 4, 2001.

<sup>13</sup> *American Metal Market*, "CVRD Readies Plans to Build a Mini-mill," October 31, 2000.



On January 16, 2001, Representatives James Oberstar (MN) and Bart Stupak (MI) requested that the Commerce Department's Bureau of Export Administration initiate an investigation under section 232 of the Trade Expansion Act of 1962 to determine whether imports of iron ore and semifinished steel threaten to impair the national security of the United States. Their request noted the devastating impact that imports of iron ore and semifinished steel were having on the U.S. iron ore/taconite industry, its workers and the local economies of the communities they represent. In particular, they noted the dramatic increase in imports from Brazil and the efforts by Brazilian iron ore and semifinished steel producers to construct new plants whose output is targeted at the U.S. market. Commerce is currently reviewing this request.

### **3. *Government Aid Programs Potentially Benefitting the Cattle and Beef Industries in Selected Countries***

Late last summer, Commerce received several letters from Members of Congress stressing the importance of the cattle and beef industries in the United States and requesting that the SEO undertake an analysis of foreign government aid to the cattle and beef industries in various countries. The letters expressed concern about both the sustained period of depressed cattle prices and the contraction of the nation's herd size. While the fed-cattle industry in the United States is the largest in the world, and we are the world's largest producer of beef, the United States remains a net beef importer<sup>14</sup> and there is concern that foreign government subsidies are contributing to unfair competition in the U.S. market and may impede market access for U.S. cattle and beef exports to markets overseas.

SEO staff have undertaken an in-depth examination of potential foreign government subsidy practices in a number of major cattle and beef trading countries which may unfairly enhance exports from those countries. Our analysis is contained in Attachment 3 to this report. SEO staff examined the major foreign cattle and beef production centers identified in the Congressional requests, including Argentina, Australia, China, Brazil, the EU, Japan, Korea, New Zealand, and Uruguay. In the course of this analysis, various avenues of information were pursued and reviewed including the size of particular countries' exports and imports, government aid specific to the cattle and beef industries, WTO-notified subsidy programs, information from the Agriculture and Farming Ministries of the respective countries, as well as a wealth of information on these markets published by the U.S. Department of Agriculture's Foreign Agricultural Service. SEO staff worked with the Department of Agriculture and the Department of State to research cattle and beef subsidy programs which heretofore had perhaps not been notified to the WTO, or were new within the last year.

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<sup>14</sup> "Briefing Room: Cattle," *Economic Research Service, United States Department of Agriculture*. Website available at: <http://www.ers.usda.gov/briefing/cattle/index.htm>.

Attachment 3 provides an overview of potential subsidy programs which could either directly or indirectly aid the cattle and beef industries of the countries mentioned above. These programs range from those providing assistance for disease control to those providing interest rate subsidies or guarantees on loans. However, the analysis contained in the attachment is not intended to address the consistency of any of the industry or government practices discussed with either U.S. laws or international rules, and it does not constitute an official finding or determination under any U.S. law or international agreement.<sup>15</sup> Rather, the purpose of our examination was to make the information more readily available to the U.S. cattle and beef industries. We will continue to monitor these programs closely. The attachment discusses areas in which SEO staff will focus their attention and direct future research.

#### **4. Study on the Migration of U.S. Film and Television Production**

Last year, Commerce was asked to examine the flight of U.S. television and cinematic film production to foreign countries, particularly Canada. In September 2000, Commerce received an additional request from a bipartisan group of Members of Congress asking that the final report address certain specific issues. SEO staff played an integral role in the writing and development of the final report, which was issued on January 18, 2001.

The report examines the causes of the loss of film production in the United States, particularly with respect to key states such as California, New York, Illinois, Texas, Florida, and North Carolina, and gauges the effects of the loss on the economies and communities of the states involved. There is a number of factors that have contributed to the loss of film production in the United States, including globalization in the industry, rising production costs in the United States, and the effects of new technologies. The report also examines a number of government practices, such as wage and tax credits and training programs, that various foreign governments have instituted to attract film production to their countries.

The purpose of the report was not to quantify or weigh these factors, or even to segregate them in order of importance. Rather, the purpose of the study was to gain a better understanding of the short- and long-term factors that affect the location of U.S. film production and to identify areas where further study is needed. Finally, the report identifies ideas generated within the industry to alleviate some of the problems associated with runaway film production in a way consistent with the economic realities of modern film production and sensitive to the needs of adversely affected communities and workers. A full text of the report, *The Migration on U.S. Film and Television Production, The Impact*

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<sup>15</sup> We also note that, while agricultural subsidies are subject to WTO rules, they are most directly governed by the rules on export subsidies and domestic support set forth in the Agreement on Agriculture, which differ from the generic rules contained in the Agreement on Subsidies and Countervailing Measures.

of “Runaways” on Workers and Small Businesses in the U.S. Film Industry is available at [http://www.ita.doc.gov/media/x\\_newfram.html](http://www.ita.doc.gov/media/x_newfram.html).

## **D. U.S. Enforcement and Advocacy Efforts**

The United States pursues enforcement of U.S. rights under the Subsidies Agreement through WTO dispute settlement proceedings, bilateral contacts and other actions. Although any decision to initiate a dispute settlement proceeding must carefully take account of the balance of U.S. interests, our general and overarching policy objectives remain aimed at discouraging distortive subsidization and preventing or remedying harm caused to U.S. producers and workers by such subsidies. These objectives are expressed clearly in the URAA, and they provide the context in which potential subsidy enforcement complaints have been, and will continue to be, considered. USTR and Commerce work closely with one another and with the full range of federal agencies – such as the Departments of State, Treasury and Agriculture – in fulfilling this mission. This interagency cooperation is also crucial to the success of our efforts to protect and defend U.S. interests in other circumstances involving subsidy rules, such as in the explanation and defense of U.S. measures targeted by others in WTO dispute settlement and in the assistance we provide to U.S. exporters and respondent agencies subject to foreign CVD actions. In the following section, we summarize some of the principal subsidy-related disputes and activities in which the United States has been involved over the past year.<sup>16</sup>

### **1. *Addressing Foreign Subsidies Affecting U.S. Interests***

#### **Australia: Prohibited Export Subsidies on Automotive Leather**

On June 21, 2000, the United States resolved a dispute it had brought to the WTO over subsidies to Australia’s sole exporter of automotive leather. Under an agreement reached following a WTO review panel report in favor of the United States, the subsidy recipient agreed to a partial repayment of the prohibited export subsidy it had received, and the Australian government committed that it will exclude this industry from current and future subsidy programs, and will provide it no other direct or indirect subsidies.

This dispute began on October 7, 1996, following receipt of a petition filed under Section 301 of the Trade Act of 1974 by the U.S. leather industry, when the United States requested consultations with Australia concerning subsidies available to leather producers under Australia's Textile, Clothing and Footwear Import Credit Scheme (TCF scheme) and other subsidies granted or maintained, which are prohibited under Article 3 of the Subsidies Agreement. Generally, the TCF scheme provided credits to eligible companies to obtain import duty reductions that are determined, in part, on the basis of the value of

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<sup>16</sup> Information about WTO dispute settlement proceedings is available to the public on the World Wide Web at: [http://www.wto.org/wto/english/tratop\\_e/dispu\\_e/distab\\_e.htm](http://www.wto.org/wto/english/tratop_e/dispu_e/distab_e.htm).

export sales and the extent of Australian value added in the exported product(s). After consultations were held on October 31, 1996, the parties reached a settlement announced on November 25, which included an agreement by Australia to excise automotive leather from eligibility under the TCF scheme (and another export subsidy program) by April 1, 1997.

However, Australia soon thereafter announced a new package of subsidies to the sole Australian exporter of automotive leather, consisting of loans on noncommercial terms and outright grants. On November 10, 1997, the United States requested WTO consultations on the new measures, alleging that they constituted *de facto* export subsidies. A panel was established in June 1998, and on May 25, 1999, it issued a report finding that Australia had granted \$A30 million in prohibited *de facto* export subsidies, but that the loans on noncommercial terms were not export subsidies. The report was adopted by the WTO Dispute Settlement Body (DSB) on June 16, 1999, and Australia was given 90 days to withdraw the prohibited export subsidies. Neither party appealed the report.

In a September 20, 1999, communication to the DSB, Australia claimed to have implemented the panel recommendation by arranging for the exporter to repay A\$8.065 million of the A\$30 million grant -- just under 27% -- which Australia contended "covered any remaining inconsistent portion of the grants made under the Grant Contract". At the same time, however, Australia announced that it intended to provide a new, A\$13.65 million loan on noncommercial terms to the exporter's parent holding company, effectively reimbursing the leather exporter and its parent for the grant repayment.

On October 4, 1999, the United States requested that the panel review Australia's compliance under Article 21.5 of the Dispute Settlement Understanding (DSU). The United States disagreed with Australia's claim that it had complied with the DSB's recommendation that the subsidy be withdrawn, in that Australia had arranged both for only a modest repayment of the subsidy and for a simultaneous, effective reimbursement of the repayment. Australia argued that no repayment of the subsidy was necessary, or, if it was, that the partial repayment it received was sufficient. Australia further argued that the loan subsidy was a separate measure unrelated to the grant repayment. The United States argued that the repayment was insufficient because it did not accurately represent the full prospective portion of the grant. The United States further argued that there had been no repayment at all, because the partial repayment had been reimbursed by the loan subsidy to the exporter's parent company.

In a report dated January 14, 2000, the review panel agreed with the United States that Australia had failed to comply with the recommendations of the DSB that the subsidy be withdrawn. The review panel found that, as claimed by the United States, the loan subsidy had nullified the partial repayment of the subsidy. The review panel further found that, to comply with the DSB's recommendation that this particular grant subsidy be

withdrawn, the entire grant, and not just the prospective portion of the grant, had to be repaid. This went beyond the U.S. claim that only the prospective portion had to be repaid. Following the issuance of this review panel report, the United States and Australia entered into discussions that led on June 21, 2000, to the mutually satisfactory solution described above.

Canada: Export Subsidies and Tariff-Rate Quotas on Dairy Products

In early 1998, the United States, later joined by New Zealand, commenced a WTO dispute settlement proceeding involving subsidized exports of dairy products by Canada. That proceeding culminated in the October 1999 adoption by the WTO DSB of the recommendations made in the Appellate Body and panel reports. Those reports found that Canada's two-tier pricing system for milk constitutes an export subsidy under the provisions of the Agreement on Agriculture and that Canada had during 1997 and 1998 exported more subsidized dairy products than was permitted by its commitments under the Agriculture Agreement. The legal reasoning in those reports confirmed that governments cannot avoid their export subsidy commitments under the Agreement on Agriculture by entrusting authority to quasi-government entities. Along the lines of the definition of a subsidy described in Article 1.1(a)(1)(iv) of the Subsidies Agreement, the panel concluded that when governments delegate powers to such entities and such bodies perform governmental functions, their actions are no less governmental than had the government undertaken the acts.

In December 1999, the United States, Canada and New Zealand concluded an agreement establishing the time frame within which Canada would implement the DSB recommendations and bring its export subsidy programs into compliance with its obligations under the Agreement on Agriculture. Pursuant to that agreement, Canada changed several parts of its dairy program, including the elimination of one category of export subsidies – those which provided for the subsidized export of products made from surplus milk. However, individual Canadian provinces, working with the federal government in Ottawa, introduced substitute programs which in the view of the United States also are export subsidies and will have the same distorting effect on trade as did the previous programs.

Given this situation, the United States intends to request additional consultations with Canada in early February 2001. As Canada is not expected either to eliminate the subsidy element of the programs that were established in August 2000 or to confine the quantity of subsidized dairy products to the level accepted by Canada under the Agreement on Agriculture, the United States anticipates that a request for review of the Canadian programs pursuant to Article 21.5 of the Dispute Settlement Understanding will be made in mid-February. At or about the same time, the United States will request authorization to withdraw concessions pursuant to Article 22 of the Dispute Settlement

Understanding, but consideration of the request will be suspended pending completion of the Article 21.5 compliance review.

*Canada & Korea: Government Support for Semiconductor Production and Export*

In the latter half of 2000, both USTR and Commerce worked closely with U.S. industry to draw the attention of certain foreign governments to instances of possible subsidization of semiconductor production and export which could adversely affect U.S. trade interests. In the first situation, the Government of Canada was considering the possible provision of federal support, in conjunction with assistance pledged by Quebec provincial authorities, to induce a Taiwanese Dynamic Random Access Memory (DRAM) chip manufacturer, Mosel Vitelic, to build a fabrication facility in Quebec province. For several years, the Canadian government had actively sought to attract semiconductor investment to Canada in an effort to spur technological development and diversification. Canada's federal industry ministry had pursued formal policies since 1996 to attract such foreign investment, and had signaled a willingness to provide federal support and assistance to ensure success. When Mosel Vitelic announced plans to construct a DRAM fabrication facility outside Taiwan, Canadian authorities at both the federal and provincial levels competed aggressively for the investment. After fierce competition among several of the Canadian provinces, Mosel had apparently reached an agreement with Quebec authorities that was conditioned on some level of federal participation. The total subsidy package under consideration – potentially consisting of equity investments, tax credits, loans and loan guarantees – was rumored to be as much as U.S.\$1.5 billion, amounting to nearly two-thirds of the estimated construction and start-up cost.

Particularly insofar as the bulk of the Mosel plant's production was anticipated to be destined for the depressed U.S. DRAM market, USTR and Commerce made several interventions with Canadian authorities to signal concern over the magnitude of government subsidies reportedly being contemplated. The question of federal support for this investment also came under considerable criticism within Canada on both policy grounds and in light of the doubtful viability of the proposed project. On December 15, 2000, Canada's Industry Minister announced that Mosel Vitelic had withdrawn its application to build a fabrication facility in Ste-Anne-de-Bellevue, Quebec. Although the company cited "market variables" as the reason for withdrawing its proposal, the ministry noted that it has also conveyed concerns to the company regarding its business plan as part of its "exhaustive due diligence process."

In another development regarding foreign government support to the semiconductor industry, very early in 2001, representatives of the U.S. semiconductor industry brought to the attention of Commerce and USTR the fact that the government-owned Korea Development Bank (KDB) intended to purchase bonds equivalent of up to 80 percent of maturing corporate bonds issued by Hyundai Electronics, Ltd. (HEI), among other companies. HEI is one of the world's largest producers of semiconductors, and exports

the preponderance of its production. The company recently has experienced heavy losses across all of its product lines, and carries an estimated \$8 billion in debt, of which over \$2 billion comes due in 2001. Korean government officials claimed that the underwriting would reflect market interest rates, be done only for "viable" companies with feasible restructuring plans, and was necessary in order to compensate for "market intermediary functions [which were] not working properly." However, it was apparent that the action was taken essentially because the poor economic situation of HEI precluded it from obtaining new or renewed credit from private market sources, and it is questionable whether the interest rate applicable to the bonds reasonably reflects the extent of commercial risk that would normally be associated with lending to a firm in such tenuous circumstances. Among other steps which the Korean government appears to have taken to ease HEI's financial burden are a special waiver of its debt ceiling from creditor banks and pressure on Korean banks to increase limits on export financing loans to HEI.

USTR and Commerce have been carefully monitoring these developments and, working with other federal agencies, we have questioned Korean government officials about the nature and extent of these apparent bailout efforts and their consistency with Korea's international obligations, including under the WTO Subsidies Agreement. We will continue to watch the situation closely and, if necessary, will seek enforcement of U.S. rights in the WTO, should such action be warranted.

*Spain: Subsidies to Specialty Steel*

On November 14, 1996, eleven member companies of the "Specialty Steel Industry of North America" (SSINA) requested that the United States seek WTO dispute settlement consultations with the EU with respect to a provision of Spanish tax law which permits deductions from corporate income tax for 25 percent of the value of foreign investments that are "directly related to exporting goods and services." The companies alleged that the Spanish specialty steel producer, Acerinox, has benefitted from these tax concessions in exporting semi-finished stainless steel feedstock to its subsidiaries in the United States and elsewhere.

Prior to receiving the industry's request, the United States had posed questions about this program during the course of the WTO Subsidies Committee's review of the EU's 1995 subsidies notification and expressed concerns to EU officials informally and during Committee discussions about the compatibility of this measure with the Subsidies Agreement's prohibition of export subsidies. Following additional exchanges with both the EU and the domestic industry, on July 30, 1997, the competition authorities of the European Commission announced the initiation of a formal investigation to determine the compatibility of the tax provision with the EU's state aids rules in force for coal and steel products. In a communication published on October 31, 1997, in the Official Journal of the European Communities, the competition authorities issued a preliminary finding that the

tax scheme appears to qualify as state aid that is inconsistent with the applicable state aids rules.

In December 1998, USTR formally reiterated to the European Commission its interest in the EU's progress in resolving this matter, and it has followed up with informal inquiries to EU trade and competition officials periodically since then. We recognize that the use of this Spanish tax provision may have contributed to the expansion of Acerinox's facility in Kentucky, and brought about economic development benefits for that region. However, as we indicated in last year's report, the United States also remained interested in the ultimate disposition of these practices in the EU.

On October 31, 2000, the Commission competition authorities issued a final decision that the Spanish law is incompatible with EU state aid rules for the steel sector. Although Acerinox will not be required to reimburse any past aid received, the Spanish authorities must repeal or modify the provisions concerned in order to come into conformity with state aid rules.

At the same time, for similar reasons, the Commission announced that it is investigating under the Steel Aid Code the French system of provisions for setting up branches abroad contained in Articles 39 *octiers* A and D of the French tax law. These Articles allow companies setting up branches abroad to establish a temporary tax-free provision equivalent to, in the case of commercial establishments, the losses incurred by the foreign establishment but not exceeding the size of the investment or, in the case of industrial, agricultural or services establishments, up to 50 percent of the amount of the investment. We intend to continue to monitor developments in this investigation.

## **2. *Non-U.S. WTO Disputes with Systemic Importance***

### ***Canada & Brazil: Export Financing for and Measures Affecting the Export of Civil Aircraft***

Beginning in 1996, Canada requested consultations with Brazil concerning "certain export subsidies" granted under Brazil's PROEX export financing program to foreign purchasers of Brazil's EMBRAER aircraft. Later, in 1997, Brazil brought a separate dispute against certain alleged subsidies granted by the Canadian federal government or its provinces that support the export of civilian aircraft from Canada. In 1998, both of these disputes were referred to panels. Final reports were issued by the two panels in March 1999, and appellate decisions in both cases emerged in August 1999. Each side then contested the adequacy of the other side's implementation of the panels' decisions and asked for further WTO review. The WTO ultimately concluded that Brazil had not fully withdrawn the export subsidies at issue in its case, and therefore had not fully implemented the panel's decision. It rejected Brazil's challenge to Canada's implementation. In December 2000, the WTO DSB approved Canada's request for authorization to suspend



for six years C\$344.2 million per year in tariff concessions and other obligations owed to Brazil.

The panel reviewing the Canadian measures affecting the export of civilian aircraft found evidence of both a *de jure* and a *de facto* export subsidy. In that dispute, Brazil alleged that several Canadian measures available to the civilian aircraft industry constituted prohibited export subsidies. The panel found that two programs – the Canada Account and Technology Partnerships Canada (TPC) – constituted prohibited export subsidies. The panel determined that the Canada Account program provided export credits at below-market rates to its domestic civilian aircraft industry and concluded that such credits were contingent in law on export performance.

With respect to the TPC program, the panel's analysis and findings served to clarify several previously ambiguous aspects of the definition of a *de facto* export subsidy. Brazil alleged that this subsidy provided royalty-based financing at below-market rates of return for investments in projects that result in a high technology product for sale in export markets. The panel found that "TPC funding in the regional aircraft sector is expressly designed and structured to generate sales of particular products, and that the Canadian Government expressly takes into account, and attaches considerable importance to, the proportion of those sales that will be for export, when making TPC contributions in the regional aircraft sector." The panel went on to conclude that "these facts demonstrate that TPC assistance to the Canadian regional aircraft industry would not have been granted but for some expectation of exportation or export earnings."

Significantly, in making its determination, the panel rejected an argument from Canada that the export orientation of the industry should not be taken into consideration. The panel found that this factor, while not dispositive, nevertheless was one of several that should be considered. In addition, the panel rejected the Canadian argument that, in order for a subsidy to be contingent upon export performance, there must be some form of penalty for not realizing increased export sales. The panel found this argument to be insufficient to demonstrate that a subsidy would not have been granted but for anticipated exportation or export earnings.

In a second important finding, the panel agreed with Brazil and the United States that the proper approach for determining the existence of a subsidy is to determine whether the recipient received something on better-than-market terms. Canada (echoed by the EU) had argued that a government practice is a subsidy only if it involves a cost to the government. The "cost to government" vs. "benefit to recipient" issue had been a source of disagreement between the United States and its trading partners for many years, and the panel's decision confirms the United States' longstanding views on this fundamental issue for effective WTO subsidy rules.

The Appellate Body upheld the panel's determination on both of these important issues.

The dispute brought by Canada against Brazil's export financing program for civil aircraft addressed several issues relating to the proper interpretation of item (k) of Annex I to the Agreement and the applicability of the export subsidy prohibition to developing countries. Under Article 27 of the Subsidies Agreement, the prohibition against the provision of export subsidies does not apply to developing countries, such as Brazil, for a period of eight years, as long as the country in question has met several conditions. These conditions include the phase-out of the export subsidies over the eight-year period and ensuring that the level of export subsidies does not increase during that period.

In this case, Canada alleged that Brazil's PROEX export financing program (insofar as it applies to civil aircraft) is subject to the prohibition on the provision of export subsidies because Brazil has not adhered to the necessary conditions laid out in Article 27. The panel ruled that Brazil has not been phasing out its export subsidies over the eight-year period since entry into force of the Subsidies Agreement, and that it has increased the level of its export subsidies. Consequently, the panel found that because Brazil has failed to comply with the conditions of Article 27.4, the prohibition of export subsidies is applicable to Brazil. Accordingly, payments under PROEX were found to constitute prohibited export subsidies. The Appellate Body affirmed the panel's decision. The panel's and Appellate Body's findings in this dispute are significant because they suggest that the conditions for enjoying the special and differential treatment accorded developing countries under the Subsidies Agreement will be rigorously applied.

Before leaving the topic of subsidies and aircraft, among other developments, it bears noting that the United States has in the past year grown increasingly concerned by indications that certain European governments intend to support the development of Airbus Industrie's new, super-jumbo Airbus A380 aircraft with "reimbursable" loans that may not be on commercial terms. In December 2000, Airbus formally launched its A380 program with 60 firm orders and 27 options. The total development costs of this program are estimated to be close to \$12 billion. Reports are that, along with the four original Airbus partners (France, Germany, Spain and the UK), five other EU member states (Belgium, Finland, Italy, the Netherlands and Sweden) may provide up to \$4 billion, or one-third, of the total development costs. The United States, both publicly and in consultations with the EU held this January, has stated that Airbus – as a mature company with about half of the world market for large civil aircraft – should no longer be receiving subsidized government support.

### **3. *Defending U.S. Interests in WTO Disputes Brought by Others***

#### **Foreign Sales Corporation Tax Rules**

In November 1997, the EU requested consultations with the United States with respect to the Foreign Sales Corporation (FSC) provisions of U.S. tax law (sections 921-927 of the Internal Revenue Code), claiming that these rules constituted a subsidy inconsistent with U.S. obligations under both the WTO Subsidies and Agriculture Agreements. The FSC provisions provide exporters with a partial tax exemption on certain foreign income of “foreign sales corporations,” which are foreign subsidiaries of U.S. companies. Following consultations, a dispute settlement panel was formed and issued its report on October 8, 1999, finding that the tax exemption conferred by the FSC provisions constitutes a prohibited export subsidy under the WTO Subsidies Agreement. The panel also found that the tax exemption constitutes an export subsidy under the Agriculture Agreement, thereby resulting in a violation of U.S. obligations under that Agreement. With respect to the panel’s findings under the Subsidies Agreement, the panel recommended that the United States withdraw the FSC tax exemption “with effect from” October 1, 2000.

On November 26, 1999, the United States appealed the panel’s findings, and, subsequently, the EU also appealed the panel’s resolution of certain issues. The Appellate Body circulated its report on February 24, 2000. The Appellate Body upheld the panel’s finding that the FSC tax exemption constitutes a prohibited export subsidy under the SCM Agreement, although its reasoning differed somewhat from that of the panel. The Appellate Body reversed the panel’s finding that the FSC tax exemption fell under Article 9.1(d) of the Agriculture Agreement. However, the Appellate Body found that the FSC tax exemption nonetheless was an “export subsidy” within the meaning of Article 1(e) of the Agriculture Agreement which resulted in, or which threatened to lead to, circumvention of U.S. export subsidy commitments with respect to both scheduled and unscheduled agricultural products.

The DSB adopted the panel and Appellate Body reports on March 20, 2000. On April 7, the United States informed the DSB of its intention to implement the recommendations and rulings in a manner which respects U.S. WTO obligations. Throughout the spring and summer, the Executive Branch worked with Congress and the private sector to develop legislation which would: (1) repeal the FSC provisions; and (2) provide tax treatment for foreign sales similar to that afforded by territorial-type tax regimes, such as are found in Europe. The United States consulted with the EU as the legislation was being developed, and the EU made known that it would challenge the WTO-consistency of the legislation being developed. As a result, in order to avoid further escalation of bilateral tensions, the United States and the EU agreed on September 29 on procedures to govern any EU challenge to the FSC replacement legislation. The agreement essentially provides that the WTO-consistency of the replacement legislation be resolved before considering questions relating to what, if any, countermeasures might be imposed by the EU.

After it became apparent that the United States would be unable to meet the October 1 deadline, the United States requested, and the DSB agreed, to extend the deadline to November 1, 2000. On November 15, President Clinton signed into law the FSC Replacement and Extraterritorial Income Exclusion Act of 2000 (the Act). The Act repeals the FSC provisions and establishes a new regime under which extraterritorial income – as defined in the Act – is not subject to tax.

On November 17, under Article 21.5 of the DSU and in accordance with the U.S./EU procedural agreement, the EU requested dispute settlement consultations with respect to the Act. On the same day, and also in accordance with the procedural agreement, the EU requested authority from the DSB to take countermeasures and suspend concessions in the amount of \$4.043 billion per year. On November 27, the United States objected to the appropriateness of the countermeasures and the level of suspensions proposed by the EU, thereby resulting in the referral of the matter to arbitration.

Following consultations, the EU on December 7 requested the establishment of a dispute settlement panel to review the compatibility of the Act with WTO obligations. On December 20, the DSB established a panel under Article 21.5 of the DSU to consider the EU's claims regarding the WTO-consistency of the Act. The panel is composed of the three panelists from the original proceeding. On December 21, the United States and the EU, in accordance with the procedural agreement, jointly requested that the arbitrators (also the three original panelists) suspend the arbitration proceedings until the adoption of the panel report or, in the event of an appeal, the Appellate Body report in the Article 21.5 proceeding.

Thus, as of this writing, a panel proceeding is pending to determine the WTO-consistency of the Act. Because an appeal of the panel report is likely, there will not be a final assessment of the WTO-consistency of the Act until the summer of 2001, at the earliest. If the Act is found to be WTO-consistent, that will be the end of the matter. If it is found to be WTO-inconsistent, in whole or in part, the arbitration proceeding would resume for purposes of determining whether the EU's proposed countermeasures are excessive. WTO rules provide that arbitration proceedings are to take 60 days. If the arbitrators find that the EU is entitled to impose countermeasures and/or suspend concessions, the EU then could ask for DSB approval to impose countermeasures and/or suspend concessions in the amount determined by the arbitrators.

#### *“Privatization” or “Change-in-Ownership” CVD Methodology Disputes*

On June 30, 1998, the EU requested consultations with the United States with regard to the imposition of countervailing duties on certain hot-rolled lead and bismuth carbon steel (lead bar) from the United Kingdom (UK). The EU contended that Commerce had inappropriately imposed countervailing duties on two private successor

companies to government-owned British Steel Corporation (BSC) based on a methodology that incorrectly attributed a portion of the massive subsidies originally received by BSC prior to its privatization in 1988 to the two successor companies. Following consultations held in July, a panel was established.

At the center of this dispute was the approach taken under Commerce's methodology for handling certain "pre-privatization" subsidies. In its report, the panel found that Commerce had imposed countervailing duties on U.S. imports from the two privatized companies in violation of the Subsidies Agreement. In reaching its decision, the panel disagreed with how Commerce accounts for the privatization of a government-owned company and determined that an investigating authority (such as Commerce) had to reassess whether pre-privatization subsidy benefits continue to exist after a company is sold to new owners.

The panel also clarified the applicable standard of review. It found inapplicable the standard of review expressly set forth in the WTO Antidumping Agreement, which provides that dispute resolution panels should uphold permissible interpretations of that agreement by national administering authorities, even if the panels themselves would have reached different conclusions.

On January 27, 2000, the United States notified the DSB that it would appeal the panel's decision.

The Appellate Body circulated its report on May 10, upholding the panel finding, although its reasoning was somewhat different. In particular, the Appellate Body emphasized that an investigating authority could presume the continuation of a subsidy benefit over a period of years. However, it agreed with the panel's holding that if the company under investigation was a different "legal person" from the original subsidy recipient, an analysis of the privatization transaction had to be undertaken to determine whether a subsidy benefit could be attributed to the privatized company. The Appellate Body also stated that its findings were limited to the particular circumstances of the case before it.

While the panel and Appellate Body proceedings were pending, Commerce was conducting a "sunset review" of the countervailing duty order on UK lead bar. In the course of that review, the U.S. petitioners expressed no interest in maintaining the order, and requested that the order be revoked with retroactive effect so as to cover the administrative reviews that were the subject of the WTO dispute. As a result, by the time the Appellate Body issued its report, Commerce already had revoked the order and canceled the imposition of any countervailing duties on imports covered by the contested administrative reviews. Accordingly, at the DSB meeting on July 5, 2000, the United States stated that no further action was necessary to implement the recommendations of the DSB.

While panel proceedings were ongoing, on February 2, a three-judge panel of the Court of Appeals for the Federal Circuit (CAFC) found Commerce's privatization or "change of ownership" methodology to be inconsistent with U.S. law. This case – *Delverde, SRL v. United States* – involved a transaction between two private firms, but the methodology employed by Commerce was essentially the same as the methodology it used to examine the privatization of government-owned firms. In the meantime, the CAFC denied Commerce's request for a rehearing by the entire court, and the Administration declined to seek further review by the U.S. Supreme Court. Accordingly, Commerce began the process of reexamining its privatization and change of ownership methodologies in light of the *Delverde* decision. As part of this process, Commerce requested remands from the Court of International Trade (CIT) in those cases where these methodologies were at issue in order to allow Commerce to make revised determinations consistent with the CAFC's decision.

On November 10, 2000, the EU requested dispute settlement consultations with respect to 14 outstanding U.S. countervailing duty orders involving imports from various EU member states in which there was a change-in-ownership issue. Consultations were held on December 7.

Shortly after the EU consultation request, Commerce issued draft redeterminations in four of the cases in which it had obtained remands from the CIT. In these redeterminations, Commerce applied a revised methodology under which it examined, first, whether the producer/exporter of the subject merchandise was the same person that had received a subsidy prior to privatization or a change in ownership. In these four cases, based upon a review of the record evidence, Commerce determined that the entity was the same and, accordingly, determined that the benefit from the original subsidies continued. If Commerce had found the pre-sale and post-sale entities to be legal different persons, it would have then analyzed the privatization transaction to determine whether a subsidy had been provided to the post-sale entity.

On December 21, 2000, Brazil also requested dispute settlement consultations with respect to Commerce's privatization methodology. The two U.S. countervailing duty measures cited in the consultation request are a sunset review determination in cut-to-length plate from Brazil and the suspended final determination in certain hot-rolled steel from Brazil. Consultations were held in mid-January 2001.

#### *EU's Challenge of CVD Review of Certain Corrosion-Resistant Carbon Steel Flat Products from Germany*

On November 10, 2000, simultaneous with its request regarding the 14 CVD orders where privatization or change in ownership is at issue, the EU also requested dispute settlement consultations with the United States with respect to the imposition of countervailing duties on certain corrosion-resistant carbon steel flat products from

Germany. The main issue under dispute in this case relates to the application of *de minimis* subsidy rules in a “sunset review” conducted by Commerce. In the review in question, Commerce found that subsidization was likely to continue or recur if the countervailing duty order in question were terminated; it also found separately, for use by the U.S. International Trade Commission in its injury inquiry, that the net countervailable subsidy likely to prevail was 0.54 percent. The EU alleges that this action was inconsistent with the Subsidies Agreement. According to the EU, the 1 percent *de minimis* standard for countervailing duty investigations found in Article 11.9 of the Subsidies Agreement also applies to sunset reviews. Because the subsidization rate found by Commerce was less than 1 percent, the EU asserts that Commerce was obligated to revoke the order. Consultations were held on December 8.

*Canada’s Challenge of CVD Law’s Treatment of Export Restraints as Potential Subsidies*

On May 19, 2000, Canada requested consultations with the United States regarding U.S. measures that treat a government-directed or -imposed restraint on exports of a product as a potential subsidy to other products made using or incorporating the restricted product if the domestic price of the restricted product is affected by the restraint. The specific measures identified by Canada were: (1) portions of the Statement of Administrative Action (SAA) accompanying the URAA; and (2) portions of the preamble to Commerce’s 1998 notice of final rulemaking promulgating substantive CVD regulations. Consultations were held on June 15. On July 24, Canada requested that the DSB establish a panel. In its panel request, Canada identified the measures as: (1) section 771(5) of the Tariff Act of 1930, as amended, as interpreted by the SAA and the preamble; and (2) U.S. practice thereunder. (Section 771(5) defines the term “subsidy” for purposes of the U.S. countervailing duty law.) The DSB established a panel at its meeting on September 11, and Australia, the EU and India reserved their rights as third parties.

From the standpoint of countervailing duty methodology, the key issue in this dispute is whether, as alleged by Canada, an export restraint can never, under any set of circumstances, constitute a subsidy. In its submissions to the panel thus far, the United States has taken the position that, based upon the application of standard rules of treaty interpretation, Canada’s allegation is unfounded.

An even more important issue in the dispute, however, is a jurisprudential one. None of the measures cited by Canada mandates that Commerce treat an export restraint as a subsidy. Section 771(5) largely tracks the language of Article 1.1 of the Subsidies Agreement, and does not even mention export restraints. Moreover, since the URAA took effect, Commerce has never found an export restraint to be a subsidy. Thus, in the U.S. view, there is no “practice” of treating export restraints as subsidies. The United States has argued that, under these circumstances, what Canada actually is asking the panel to do is to issue, in the abstract, an authoritative interpretation of the Subsidies Agreement to

the effect that export restraints can never constitute a subsidy. The United States has opposed this attempt by Canada to circumvent the relevant provisions of the WTO agreements that limit the power to issue authoritative interpretations to the Ministerial Conference and the General Council. On December 12, the United States filed a request for preliminary rulings by the panel which, if granted, would result in the dismissal of Canada's complaint. The first panel hearing was held on January 18, 2000.

#### **4. *Defending Interests of the United States in Foreign Countervailing Duty Cases***

##### **Canadian Countervailing Duty Investigation of Grain Corn from the United States**

On June 19, 2000, the Manitoba Corn Growers' Association filed a countervailing duty complaint with the Canadian Customs and Revenue Agency (CCRA) against grain corn from the United States.<sup>17</sup> The complaint alleged that over 36 U.S. federal and state programs were providing subsidies to corn producers in the United States and that exports of U.S. corn were injuring the corn producers in western Canada. Although the U.S. government submitted a formal argument in opposition, the CCRA began a countervailing duty investigation on August 9, 2000.

As part of its investigation, the CCRA issued several questionnaires to the U.S. government and several state governments requesting information regarding the alleged assistance programs. Working with USTR, the SEO provided extensive technical assistance to the Department of Agriculture and the various state governments involved in answering the Canadian questionnaires. On November 7, 2000, the CCRA preliminarily determined that three U.S. government programs provided countervailable subsidies to U.S. corn growers and imposed a countervailing duty rate of \$.57 per bushel.<sup>18</sup> None of the alleged state programs was found countervailable.

Throughout the countervailing duty investigation, USTR, Commerce and the Department of Agriculture, have forcefully defended the interests of the U.S. corn industry. In addition to providing extensive factual information to the Canadian authorities, numerous procedural objections and substantive arguments were formally made in writing and in the course of numerous meetings held with the Canadian authorities.

On February 5, 2001, the CCRA is scheduled to issue its final determination in the countervailing duty investigation. On March 7, 2001, the Canadian International Trade Tribunal is scheduled to issue its final injury determination. If these findings are affirmative,

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<sup>17</sup> An antidumping complaint was also filed at the same time.

<sup>18</sup> CCRA also estimated a preliminary dumping margin of US \$1.01 per bushel.



and countervailing duties are imposed, the U.S. government will consider pursuing an appeal in appropriate fora.

*Chilean Countervailing Duty Investigation of Milk Powder from the United States*

On October 21, 1999, the Chilean government initiated a countervailing duty investigation of milk powder from the United States and the EU. The investigation involving the United States included 12 federal programs, all administered by the Department of Agriculture. USTR, Commerce and the Department of Agriculture consulted with the Chilean government prior to initiation and throughout the case to ensure that U.S. views and interests were being considered. In addition, the three agencies made certain that all relevant information was provided to the Chilean government in response to its requests in a timely manner in order to be considered in the preliminary determination. The preliminary determination was issued on January 3, 2000, instituting the application of a provisional countervailing duty of 21 percent on imports of the products under investigation. That rate – lower than the amount of subsidy calculated by the Chilean government on the three programs found to be countervailable – corresponded to the margin of injury, estimated on the basis of the decline experienced by domestic prices since the mid-1990s.

On July 12, 2000, a final countervailing duty was imposed also equal to 21 percent. However, on July 17, 2000, the U.S. Embassy in Santiago was informed that the 21 percent countervailing duty had been revoked. In its place, the Government of Chile had imposed a 16 percent duty on all imports of milk powder and fluid ultra heat treated milk, as a safeguards measure.

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## **ATTACHMENT 1**

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## **SUBSIDIES ENFORCEMENT:**

### ***ASSISTING U.S. EXPORTERS TO COMPETE EFFECTIVELY***

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**Subsidies Enforcement Office:** The Department of Commerce's Import Administration is responsible for coordinating multilateral subsidies enforcement efforts. The primary mission is to assist the private sector by monitoring foreign subsidies and identifying subsidies that can be remedied under the Subsidies Agreement of the World Trade Organization, of which the United States is a member. To fulfill this mission, Import Administration has created the Subsidies Enforcement Office (SEO). As part of its monitoring efforts, the SEO has created a Subsidies Library, which is available to the public via the Internet (<http://ia.ita.doc.gov/esel>). The goal is to create an easily accessible one-stop shop that provides user-friendly information on foreign government subsidy practices.

**Types of Subsidies:** A subsidy can be almost anything a government does, if the following conditions are met: (1) a financial contribution is made by a government or public body and (2) a benefit is received by the company. Trade rules permit remedies in circumstances when subsidies are "specific" (*i.e.*, provided to a limited number of companies, such as all exporters) and have caused adverse trade effects. Subsidies can take a variety of forms. Following are some of the types of foreign subsidies that could place a U.S. exporter at a competitive disadvantage vis-a-vis a foreign competitor.

- o **Export financing** at preferential rates.
- o **Grants or Tax exemptions** for favored companies or industries.
- o **Loans that are conditioned on meeting local content requirements**, or are contingent upon the use of domestic goods over U.S. exports (commonly referred to as "import substitution subsidies").

**Types of Remedies:** Remedies for violations of the Subsidies Agreement could involve requiring the foreign government to eliminate the subsidy program or its adverse effect, or, as a last resort, to authorize offsetting compensation.

**Working Together to Assist U.S. Exporters:** The SEO welcomes any information about foreign subsidy practices that may adversely affect U.S. companies' export efforts. The SEO can evaluate the subsidy in relation to U.S. and multilateral trade rules to determine what action may be possible to take to counteract

***As an illustration:***

A U.S. exporter is bidding on a project in Country A and is competing against an exporter from Country B. The company from Country B offers a bid that is extremely low, possibly even below what one would assume to be the cost of production. The U.S. exporter may have knowledge that the reason the company from Country B is able to bid so low is that it is being assisted by its government with low cost loans and payment of various export related expenses. In such a situation, we would encourage the U.S. exporter to collect as much information as possible concerning the potential subsidies and then contact us with all of the relevant information. We would then check further into the types of subsidies being received and determine whether any action should be taken.

**Questions and information can be referred to:**

**Carole Showers** tel.: (202) 482-3217  
fax : (202) 501-7952  
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such adverse effects. By working together to monitor foreign subsidies and enforce the Subsidies Agreement, we can ensure that U.S. companies are competing in a fair international trading system.

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## ATTACHMENT 2

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# THE SUBSIDIES ENFORCEMENT LIBRARY

[<http://ia.ita.doc.gov/esel/>]

## **First Screen**

### **ELECTRONIC SUBSIDIES ENFORCEMENT LIBRARY**

- < **WTO Agreement on Subsidies and Countervailing Measures**
- < **Overview of the Subsidies Enforcement Office**
- < **Subsidy Programs Investigated by DOC**
- < **WTO Subsidies Notifications**

#### ***Reports to Congress***

- < **1998 Annual Report on Subsidies Enforcement - February 1998**
- < **1999 Annual Report on Subsidies Enforcement - February 1999**
- < **2000 Annual Report on Subsidies Enforcement - February 2000**
- < **2001 Annual Report on Subsidies Enforcement - February 2001**
- < **Review and Operation of the WTO Subsidies Agreement - June 1999**

## **Description of Choices**

- < **WTO Agreement on Subsidies and Countervailing Measures**

This links the visitor to the World Trade Organization Agreement on Subsidies and Countervailing Measures as found in the Multilateral Agreement on Trade in Goods. Information in this Agreement includes the definition of a subsidy and provides general guidelines under which remedies may be put in place.

- < **Overview of the Subsidies Enforcement Office**

This links the visitor to the informational page found in Attachment 1 to this Report. As shown in Attachment 1, information contained on this page includes a general overview of the SEO, and contact information for the SEO.

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### Subsidy Programs Investigated by DOC

This links the visitor to subsidy programs which were analyzed by Import Administration staff during countervailing duty (CVD) proceedings. This section is newly redesigned and will more easily provide visitors access to the information which they are seeking. After clicking on the above choice, visitors will be linked to a page which has an alphabetical drop-down list of countries which were investigated during CVD proceedings. As of December 2000, this list comprised 51 countries. After selecting a country to review, visitors have the option of selecting subsidy programs within that country that are not “in name” specific to a certain industrial sector (“general”) and programs that are used only by certain sectors (“industry”). For example:

Argentina					
Subsidy Type	Program Codes				
General	1	2	3	4	5
Industry	1	2	3	4	5

Thus, if a visitor were interested in finding more information about subsidies to the steel sector in Argentina, he or she would click on the “Industry” link in the above table and then examine the information provided. Once a subsidy program of interest is found in this section, visitors are provided a description of the program and are able to easily view the cases in which the program was analyzed. Further information about the program in a specific case can be easily found by clicking on the hyperlinked cite to the Federal Register notice in which a complete description of the program and Commerce’s analysis is provided.

The second sub-division of programs within this topic, as shown above, is based on the classification of the subsidy program by Commerce. There are five categorizations: (1) countervailable, (2) not countervailable, (3) terminated, (4) not used, and (5) found not to exist. These categories track the methodology used by Commerce and found in its decisions as published in the Federal Register. Descriptions for each of these terms are provided in the Subsidies Library. This level of detail allows a visitor to the library to find the exact type of information he or she is seeking.

Using the same example as described above, if a visitor were interested in discovering which subsidy programs Commerce had countervailed involving steel products exported from Argentina, he or she would select **Argentina ± Industry ± Countervailable Programs** and then review the information provided. If more detailed information about a particular subsidy

program is required, a click of the mouse on the Federal Register cite next to the individual cases will take the visitor directly into the Federal Register notice where such information is readily available.

The following list shows the 51 U.S. trading partners which have had programs investigated in U.S. CVD proceedings, and information about which can be found in the Subsidies Enforcement database:

<b>Argentina</b>	<b>India</b>	<b>Philippines</b>
<b>Australia</b>	<b>Indonesia</b>	<b>Poland</b>
<b>Austria</b>	<b>Iran</b>	<b>Portugal</b>
<b>Bangladesh</b>	<b>Ireland</b>	<b>Saudi Arabia</b>
<b>Belgium</b>	<b>Israel</b>	<b>Singapore</b>
<b>Brazil</b>	<b>Italy</b>	<b>South Africa</b>
<b>Canada</b>	<b>Japan</b>	<b>Spain</b>
<b>Chile</b>	<b>Kenya</b>	<b>Sri Lanka</b>
<b>Colombia</b>	<b>Korea</b>	<b>Sweden</b>
<b>Costa Rica</b>	<b>Luxembourg</b>	<b>Taiwan</b>
<b>Denmark</b>	<b>Malaysia</b>	<b>Thailand</b>
<b>Ecuador</b>	<b>Mexico</b>	<b>Trinidad and Tobago</b>
<b>El Salvador</b>	<b>Netherlands</b>	<b>Turkey</b>
<b>European Union</b>	<b>New Zealand</b>	<b>United Kingdom</b>
<b>France</b>	<b>Norway</b>	<b>Uruguay</b>
<b>Germany</b>	<b>Pakistan</b>	<b>Venezuela</b>
<b>Greece</b>	<b>Peru</b>	<b>Zimbabwe</b>

### **Descriptions of Choices (continued)**

#### **< WTO Subsidies Notifications**

This will link the visitor to all derestricted WTO subsidy notifications, by country. Beneath each country's name is the date the document was submitted to the WTO and the date it was posted to the WTO website. This listing provides each type of notification, i.e., ***new and full, update*** or a ***supplement to an earlier filing***. (See discussion above in this Report.) Clicking on the name of the country next to the document of interest will take the visitor directly to that country's subsidy notification. If subsidies have been notified, a listing of those subsidies is provided, in addition to specific information concerning the subsidy program, such as the type of incentive provided, the duration and purpose of the program, and the governing law or provision of the incentive. Several of the larger countries have provided information on hundreds of subsidy practices. Although the Subsidies Agreement stipulates that the notification of a subsidy practice does not prejudice its legal status under the Agreement, these notifications do provide detailed information concerning a number of countries' subsidy measures. In the event that less than full information about the program is provided, the Subsidies Enforcement Office, working with other Agencies, seeks more detailed information.

#### ***Reports to Congress***

- < 1998 Annual Report on Subsidies Enforcement - February 1998**
- < 1999 Annual Report on Subsidies Enforcement - February 1999**
- < 2000 Annual Report on Subsidies Enforcement - February 2000**
- < 2001 Annual Report on Subsidies Enforcement - February 2001**

Links are provided for the visitor to review the most recent SEO Annual Report to Congress, as well as to review past Annual Reports.

#### ***Reports to Congress***

- < Review and Operation of the WTO Subsidies Agreement - June 1999**



This links the visitor to the June 1999 Report to Congress that reviews the operation of the WTO Subsidies Agreement.

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## **ATTACHMENT 3**

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# **Government Aid Programs Potentially Benefitting the Cattle and Beef Industries in Selected Countries**

## **Introduction**

In the late summer and early fall of 2000, the Subsidies Enforcement Office received three letters, signed by 19 Senators, expressing concern about possible subsidy programs available to cattle and beef producers in a number of countries. These letters emphasized the importance of cattle-producing farms and ranches to thousands of rural communities across the United States, as well as the recent damage done to the industry as a result of depressed prices. The letters requested that Commerce identify and examine potential subsidies and other aid programs provided to foreign cattle and beef producers in the following countries: Argentina, Australia, Brazil, China, the EU, Japan, Korea, New Zealand, and Uruguay. In their letters, the Senators considered that such information would be very important, in part, to prepare for future trade negotiations.

In order to address the concerns expressed in these letters, the SEO has undertaken an in-depth examination of potential subsidy practices in a number of major cattle and beef trading countries which may unfairly enhance exports from those countries into the U.S. market or work to impede market access abroad for U.S. cattle and beef exports. Included in this report is a brief overview of government programs examined in each of the countries and regions under review. SEO staff continue to research and monitor these practices and will provide additional information to interested parties as appropriate. This will ensure that both the U.S. cattle industry and the Congress are fully aware of important potential foreign subsidy practices. It should be noted that mention of a government aid program in this report in no way prejudices the status of that measure under WTO rules and/or whether it is addressable under those rules or U.S. law.

## **Sources**

In the course of this analysis, SEO staff examined a wide range of sources including official government documents, reports and, where available, foreign government statistics and other primary sources. Commerce officials directly consulted with representatives of the U.S. cattle and beef industry, U.S. embassy officials and cattle and beef experts at the U.S. Department of Agriculture's Foreign Agricultural Service (FAS) and Economic Research

Service (ERS). SEO staff also reviewed WTO and OECD industry and country-specific reports and notifications. In addition, staff reviewed industry reports compiled by FAS personnel working in Washington and overseas. Examples of the specific sources used include:

- FAS Attache Reports, including *Livestock and Products* and *Trade Monitoring Reports*
- “Cattle and Beef,” *United States Department of Agriculture, Foreign Agricultural Service, FASonline*
- “Agricultural Policies in OECD Countries 2000: Monitoring and Evaluation,” *Organization for Economic Cooperation and Development*, 2000.
- Notifications to the WTO Committees on Subsidies and Countervailing Measures and Agriculture
- Official documents from the European Union website
- Foreign Government Agriculture and Trade Ministry websites
- “Cattle Briefing Room” *United States Department of Agriculture, Economic Research Service, ERSonline*

The SEO staff would like to acknowledge the assistance provided by officials and staff at the Departments of State and Agriculture, particularly personnel abroad. Both agencies contributed invaluable guidance and information. We expect to continue our close working relationship as more information becomes available for analysis.

### **Background**

The fed-cattle industry in the United States is the largest in the world, making the United States the world’s largest producer of beef.<sup>1</sup> However, despite both of these factors, the United States remains a net beef importer on a volume basis. The U.S. industry is concerned that foreign government subsidies have led to unfair competition in the U.S. and overseas markets.

Most of the beef which is produced and exported from the United States is grain-finished, high-quality choice cuts. The primary export market for U.S. beef is Japan, which imports twice as much as Mexico, the second-largest U.S. beef export market. The two other main export markets are Canada and Korea.

U.S. beef imports are mostly from grass-fed cattle. These imports are generally used for processing ground beef.<sup>2</sup> Canada is the largest source of U.S. beef imports, followed by

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<sup>1</sup> “Briefing Room: Cattle,” *Economic Research Service, United States Department of Agriculture*. Website available at: <http://www.ers.usda.gov/briefing/cattle/index.htm>.

<sup>2</sup> “Briefing Room: Cattle: Trade,” *Economic Research Service, United States Department of Agriculture*. Website available at: <http://www.ers.usda.gov/briefing/cattle/Trade.htm>.

Australia.<sup>3</sup> The United States imports significantly more cattle than it exports. Beef imports have remained relatively stable between 1980 and 1998, while exports have steadily increased. For live cattle, on the other hand, imports increased steadily between 1988 and 1998, while exports showed only moderate increases.<sup>4</sup>

## Argentina

Argentina is the world's largest consumer of beef per capita; yet, improving efficiency in Argentina's cattle industry is increasing the amount of beef available for export. Argentina's cattle inventories were approximately 50 million head in 2000. Total Argentine exports of beef rose 15 percent in 1999 and are expected to have increased an additional 12 percent in 2000.<sup>5</sup> The EU accounts for the majority of Argentina's beef exports. The United States is Argentina's second most important export market, although Argentine shipments of fresh, chilled, and frozen beef are subject to a 20,000 metric ton annual tariff rate quota imposed in 1997.<sup>6</sup> The Argentine government is seeking to have this quota level increased. In mid-2000, only two months after earning a clean bill of health for its stock as free of foot and mouth disease, Argentina had to suspend all exports of fresh beef due to possible exposure of a portion of the herd to contaminated animals from Paraguay.<sup>7</sup>

Argentina's beef imports have been and are forecast to remain negligible. Exports of U.S. sweetbreads (internal organs of cattle, such as the pancreas) to Argentina, however, are expected to double in 2000. In 1999, Argentina imported \$2 million of sweetbreads from the United States.<sup>8</sup>

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<sup>3</sup> "Briefing Room: Cattle: Trade," *Economic Research Service, United States Department of Agriculture*. Website available at: <http://www.ers.usda.gov/briefing/cattle/Trade.htm>.

<sup>4</sup> "Briefing Room: Cattle: Trade," *Economic Research Service, United States Department of Agriculture*. Website available at: <http://www.ers.usda.gov/briefing/cattle/Trade.htm>.

<sup>5</sup> "Cattle and Beef," *United States Department of Agriculture, Foreign Agricultural Service, FASonline*. Website available at <http://fas.usda.gov/dlp/circular/2000/00-03LP/beef.htm>.

<sup>6</sup> As a result of bilateral negotiations under the framework of the Uruguay Round of the General Agreement on Tariffs and Trade, Argentina entered the U.S. fresh beef market and is guaranteed an annual tariff rate quota (TRQ) of 20,000 metric tons. Imports above the TRQ are subject to a duty of approximately 26 percent. Between 1927 and 1997, Argentine beef exports to the United States had been limited to cooked products because of foot and mouth disease concerns.

<sup>7</sup> "Disease Causes Argentina to Limit Cattle Slaughter," CNN.com, August 11, 2000. Website available at <http://cnn.com/2000/world/americas/08/11/food.argentina.disease.reut.htm>.

<sup>8</sup> "Argentina Livestock and Products, Annual 2000, Global Agricultural Information Network Report #AR0048," *United States Department of Agriculture, Foreign Agricultural Service*, August 8, 2000.

Argentine domestic support measures focused on the cattle and beef industries in 1999 mainly relate to disease control and animal health measures.<sup>9</sup> However, there are several other domestic assistance programs in Argentina which require additional analysis. The SEO will conduct further research into interest rate subsidies that may be available at both the federal and state levels for the retention of female cattle. The programs are used to encourage farmers to increase cattle production. They finance the retention of female cattle on the farm for breeding purposes by lowering borrowing rates for producers by two to three percentage points. The importance of this program, however, is unclear, as many of the producers either do not qualify for assistance or find the interest rates prohibitive even under the terms of the program. Slaughterhouses and cattle traders do not receive support under this program.<sup>10</sup>

The *Reintegro* tax rebate system applies to Argentine agricultural and nonagricultural products shipped outside the Mercosur region. The stated purpose of this program, in effect for the past ten years, is to rebate indirect taxes (such as provincial sales taxes) paid during the further processing of the products.<sup>11</sup> Beef exports receive indirect tax rebates of 2.7 to 12 percent, depending on the nature of the product being exported. The rebate of indirect taxes is permissible under the WTO Subsidies Agreement and U.S. law, as long as the rebate is appropriately calculated and not in excess of the amount of indirect taxes paid.

SEO personnel also intend to review several additional programs and their availability to the cattle and beef industries in Argentina. Included in our research will be Law 24,467 Programs for Small and Medium-Sized Enterprises (the *PyMES Promotion Act*). Support programs under this law may involve export credits, export financing, and other avenues of support. In addition, we will review the planned creation and funding of the Beef Promotion Board, a new entity to promote consumption of Argentine beef in overseas markets.

### Australia

Australia's largest live cattle export destination in 1999 was the Philippines, though due to trade disputes, that figure was expected to drop for 2000. Japan was Australia's largest beef export market in 1999 and further growth in that market was expected for 2000. Other major markets include the United States, Korea, Canada, and Taiwan. The United States primarily imports manufacturing-grade beef to be used in the production of hamburger patties.

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<sup>9</sup> These are measures notified as exempt from the reduction commitment, or "Green Box." See "Notification," Committee on Agriculture, G/AG/N/ARG/9, September, 23, 1999.

<sup>10</sup> Communication with U.S. Foreign Agricultural Service staff, Argentina, January 9, 2001.

<sup>11</sup> The *Reintegro* program has in the past been found countervailable in certain U.S. countervailing duty proceedings. For more information on this program, visit the SEO library website at: <http://ia.ita.doc.gov/esel/eselframes.html>

According to the Australian Ministry for Agriculture, Forestry and Fisheries, exports of beef and veal account for 60 percent of beef and veal production.<sup>12</sup>

Australian law mandates that producers pay a levy or fee on all sales of live cattle. Meat and Livestock Australia<sup>13</sup>, which is responsible for the administration of the levy collected on sales of live cattle, provides aid specifically to red meat and lamb producers. The levy is used for such things as research and development, marketing and animal health. The government matches the portion of the producer levies that are used for research and development and promotion.

Other government assistance may be provided to the cattle and beef industries by the government-owned Export Finance and Insurance Corporation (EFIC), which provides export finance and insurance to Australian exporters. Assistance from this corporation is available to all exporters, with an emphasis on assistance to exporters with a total annual turnover of less than \$A10 million. SEO staff will continue to gather information on the nature of this assistance to determine whether it is being offered on terms consistent with Australia's WTO commitments.

The SEO is also examining recent reports that the Australian government will provide \$A17 million to a new scientific project involving bovine cloning. In addition to applications directly related to dairy cattle productivity, the assistance will reportedly support activities related to the genetic engineering of cows and the storage of bovine genetic material.<sup>14</sup>

In addition, Australian beef producers potentially have access to assistance from state governments. In some instances, beef producers are eligible for certain rural programs. These programs include: the Australian Capital Territory's *Business Incentive Scheme*; New South Wales' *Regional Business Development Scheme*; the Northern Territory's *Industry and Business Assistance Scheme*; and Queensland's *Investment Incentives Scheme* and *Industry Development Scheme*. Additional sub-federal programs may also benefit the cattle and beef industry. SEO staff will continue to research both federal and sub-federal programs in Australia to determine their applicability to the cattle and beef industries.

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<sup>12</sup> Australian Ministry for Agriculture, Forestry and Fisheries website. Available at: <http://www.truss.affa.gov.au/agriculture.html>.

<sup>13</sup> Meat and Livestock Australia is a producer-owned company, and was recently formed as a result of a government examination and restructuring of the now disbanded Australian Meat and Livestock Corporation, the Meat Research Corporation, and the Meat Industry Council.

<sup>14</sup> Vanessa Williams, "Cloned Bull on the Way." *Australasian Business Intelligence*, January 19, 2001. Website available at <http://www.abix.com.au>. See also: "New foods from Dairy CRC funding," Australian Dairy Research and Development Corporation website 'What's New' section. Available at: <http://www.drdc.aust.com/>. Last visited January 23, 2001. This Australian organization is funded both by the Australian federal government and individual dairy farmers.

## **Brazil**

The cattle and beef industries comprise a large component of Brazil's economy. Brazil's cattle inventories were expected to stabilize at about 145 million head in 2000.<sup>15</sup> Recent beef production increases are driven by exports, which have increased steadily over the past three years. The EU accounts for the majority of Brazil's beef exports; however, Brazil is also the fourth largest beef exporter to the United States. Two foot and mouth disease outbreaks occurred in early 1999 in the state of Mato Grosso do Sul, and were likely attributable to unregulated cattle importation from Paraguay.<sup>16</sup> While U.S. beef exports to Brazil are insignificant, U.S. exports of bovine genetics, including breeding stock, bull semen and embryos (\$11.6 million in 1999), comprise an important share of Brazil's imports.<sup>17</sup> Brazil also imports bovine genetics from Canada, the EU, Uruguay and South Africa.

The FAS reports that government support efforts in Brazil are concentrated on animal health programs, with the goal of achieving national foot and mouth disease eradication by 2004. Another program which may provide benefits to the Brazilian cattle and beef industries is the *Regional Incentives (Administered by SUDAM/SUDENE) Program*, which provides incentives for the development of the Amazon and the Northeast Region<sup>18</sup>. The program includes provisions for income tax exemptions, reductions and tax cuts for reinvestment. Benefits under this program are available to industrial and agricultural enterprises located in the region.<sup>19</sup>

The SEO will closely look at the financial assistance provided to cattle producers through the National Bank for Economic and Social Development (BNDES). BNDES, through state and commercial private banks, provides long-term loans for pasture improvement and breeding programs. These loans carry interest rates of approximately 8 percent, significantly

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<sup>15</sup> "Cattle and Beef."

<sup>16</sup> "Brazil Livestock and Products, Annual 2000, Global Agricultural Information Network Report #BR0617," *United States Department of Agriculture, Foreign Agricultural Service*, August 1, 2000.

<sup>17</sup> "Brazil Livestock and Products, Annual 2000, Global Agricultural Information Network Report #BR0617," *United States Department of Agriculture, Foreign Agricultural Service*, August 1, 2000.

<sup>18</sup> "New and Full and Updating Notifications Pursuant to Article XV:1 of the GATT 1994 and Article 25 of the Agreement on Subsidies and Countervailing Measures: Brazil," G/SCM/N/25/BRA, *World Trade Organization*, January 8, 2001.

<sup>19</sup> The program *SUDENE Corporate Income Tax Reduction for Companies Located in the Northeast of Brazil* was investigated by Commerce in several CVD cases. However, in each case, the program was found not to have been used. For more information on this program visit the SEO library website at: <http://ia.ita.doc.gov/esel/brazil/bragen.htm>.

lower than commercial rates in Brazil, and generally have an extended grace period of up to three years.<sup>20</sup>

The *Fundo de Investimento da Amazônia (FINAM)* and *Fundo de Investimento do Nordeste (FINOR)* programs also provide financial support for the development of the Amazon and Northeast Regions. *FINAM* and *FINOR* allow businesses to deduct a portion of their income tax to be invested either regionally or for their own approved projects. The Brazilian government reports that any enterprise located in the regions can receive benefits for approved projects.<sup>21</sup> In 1999, almost 60 percent of *FINAM* resources went to agroindustrial and agricultural projects.<sup>22</sup>

### **China (PRC)**

China's improving economy has fueled an increasing demand for meat, with a trend toward high quality meats, which has led to growth in beef production and consumption. Decreased prices for red meats in 1999 slowed inventory growth, but the industry rebounded in 2000. Estimated beef production in 1999 increased to 5.1 million metric tons and was expected to reach 5.4 million metric tons in 2000.<sup>23</sup> China's beef consumption for 1999 increased seven percent, to 5.07 million metric tons, and was expected to increase another six percent in 2000.<sup>24</sup> Inventories and production of beef are expected to grow over the next several years, despite constraints on production such as limited land resources and difficulties developing modern cattle operations to produce higher-quality beef. It is expected that China's accession to the WTO will lead to an increase in U.S. beef exports, as tariffs will be reduced from 45 percent to 12 and 25 percent for frozen and chilled beef, respectively, by 2004.<sup>25</sup>

China exports minimal amounts of cattle and beef. Key markets for China's live cattle exports are Macau and Korea. The important markets for China's limited beef exports have

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<sup>20</sup> Communication with U.S. Foreign Agricultural Service staff, Brazil, December 22, 2000. For additional information on the BNDES program, see "Brazil Livestock and Products, Annual 2000."

<sup>21</sup> "New and Full and Updating Notifications: Brazil."

<sup>22</sup> Detailed information was not available as to whether and to what extent cattle and beef industries were part of this 60 percent.

<sup>23</sup> "Cattle and Beef."

<sup>24</sup> "Cattle and Beef."

<sup>25</sup> "China Livestock and Products, Semi-Annual 2000, Global Agricultural Information Network Report #CH0008," *United States Department of Agriculture, Foreign Agricultural Service*, February 4, 2000.



been Hong Kong, Israel, and Russia. Further improvements in quality will be necessary before Chinese beef exports are competitive with U.S. beef exports in third-country markets.

China's domestic beef imports have been negligible with 6,000 tons imported in 1999. Although Australia is the major supplier to China, with a 60 percent market share of total beef imports, U.S. exports have been increasing. U.S. market share of Chinese beef imports has grown from 13 percent in 1997 to 31 percent of total imports in 1999.<sup>26</sup> It is expected that total Chinese beef imports will continue to grow over the next few years.

No significant ongoing assistance by the Chinese government to cattle and beef producers has yet been identified, though the government does run a nationwide system of veterinary stations to provide services to livestock producers. However, farmers pay for these services and the stations are said to be self supporting.<sup>27</sup>

One new development does bear close watching. The Chinese government is undertaking a \$200 million development project in east-central China funded heavily by the World Bank.<sup>28</sup> Over the next several years, the project will finance the construction of feedlots and slaughterhouses and give assistance to small-scale cattle producers to try to establish a viable beef production industry that is intended eventually to be self-supporting. The SEO will continue to monitor this project as it develops.

### **European Union**

The beef and veal sector is the second largest agricultural production sector in the EU and accounts for approximately 10 percent of total agricultural production.<sup>29</sup> Aid to the EU's cattle and beef industry is available both under community-wide programs, as well as under country-specific programs. The EU's "Common Beef and Veal Regulation" came into force in July 1968 and was overhauled in January 2000. At that time, support prices were cut but direct aid payments and new subsidies were introduced. In addition to programs specific to the cattle and beef industries, many of the EU's non-industry specific agricultural programs also appear to be available to the cattle and beef industries.

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<sup>26</sup> "Cattle and Beef."

<sup>27</sup> Communication with U.S. Foreign Agricultural Service staff, China, January 6, 2001.

<sup>28</sup> "China Livestock and Products, Annual 2000, Global Agricultural Information Network Report #CH0030," *United States Department of Agriculture, Foreign Agricultural Service*, August 14, 2000.

<sup>29</sup> "CAP reform: the beef and veal sector," *European Commission, Director-General for Agriculture*, p 1.

## Community-Wide Programs

At the Community-wide level, programs available to the cattle and beef industries include:

- *Price Support Regime (Bovine Meat Sector program):* Under this program, the EU will buy beef at a set price to help stabilize the market. In order for a "normal" buy-in to take place, the Community market price must be below 84 percent of the set price, and the individual member state's market price must be below 80 percent of the set price for a period of two weeks. In order for a "safety net" buy-in to take place, EU market prices for a particular category must be below 78 percent of the set price, and individual member state's market price must be below 60 percent of the set price. If either of these situations arises, farmers are eligible to sell beef to the EU.<sup>30</sup>
- *Aid for Private Storage:* Under this program, a payment is made by the European Commission to traders who agree to store beef at their own expense for a specific amount of time, during which time the beef is effectively removed from the market. After the storage period ends, the beef remains under the ownership of the storer.
- *Payment of Premiums:* Premiums are paid to farmers willing to limit the number of livestock units per hectare (LSU/ha). An *extensification*, or supplemental, premium may be granted when the stocking density is lower than 1.4 LSU/ha.
- *Special Premium for Young Male Bovine Animals:* A special set premium is offered for young male bovine animals twice in the lifetime of each animal at the age of 10 months and over 22 months, subject to limits of 90 head in each age group and also subject to individual or regional quota limits.<sup>31</sup>
- *Premium for the Maintenance of Suckler Cow Herds:* This set premium is granted to breeders who do not deliver milk or dairy products, or whose milk production is lower than a reference quantity of 120,000 kg.
- *Additional Premium for Suckler Cow Herds in Underdeveloped Areas:* An additional premium may be granted at the national level where development in

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<sup>30</sup> CAP Monitor Publication on EU Beef Policy, Agra Europe, ERS, USDA.

<sup>31</sup> Organization for Economic Cooperation and Development, "Agricultural Policies in OECD Countries: Monitoring and Evaluation 2000, Agriculture and Food." Paris, France, 2000, page 72, table II.7 "European Union: Area and Headage Payment Rates."

the sector is lagging (Greece, Ireland, Portugal and central regions of southern Italy, Spain and France.)<sup>32</sup>

In general, there are several further areas in which SEO staff will concentrate their research and monitoring efforts. Due to the BSE (bovine spongiform encephalopathy or 'mad-cow disease') crisis that began in Europe in 1996, the European Union has developed programs to promote quality beef and veal and to help eliminate cows that may be infected with this disease. In January 2000, the European Commission adopted 14 action programs in eight member states to market and promote quality beef and veal in the 1999/2000 marketing year. These programs included:

- advertising campaigns in the media;
- dissemination of promotional information in magazines and papers;
- point-of-sale marketing measures;
- public relations measures; and
- participation at trade fairs.<sup>33</sup>

In addition, in mid-December 2000, the European Commission adopted exceptional measures as an outcome of the BSE crisis. These programs include a *purchase for destruction scheme* under which the EU budget will co-fund expenditures at a rate of 70 percent for the destruction of cattle older than 30 months, unless they tested BSE-negative from January 1, 2001.<sup>34</sup> Cattle which may potentially be infected are currently being destroyed in countries such as Portugal, where farmers are opting for the EU payment rather than waiting for scheduled BSE testing to begin.<sup>35</sup> The SEO will monitor additional programs as they come into existence to ensure that funds are not disbursed to cattle farmers under conditions which are counter to those countries' WTO obligations.

Recently, SEO staff discovered a report that the Farmers Union in the United Kingdom believes one EU scheme, *IACS*, which is a compensation plan involving EU aid for arable

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<sup>32</sup> "Updating Notification Pursuant to Article XVI:1 of the GATT 1994 and Article 25 of the Agreement on Subsidies and Countervailing Measures: European Communities," (G/SCM/N/60/EEC), December 4, 2000.

<sup>33</sup> "Promotion programmes for quality beef and veal," *European Commission*, January 26, 2000. Website available at: [http://europa.eu.int/rapid/start/cgi/guesten.ksh?p\\_action.gettxt=gt&doc=IP/00/82|0|RAPID&lg=EN](http://europa.eu.int/rapid/start/cgi/guesten.ksh?p_action.gettxt=gt&doc=IP/00/82|0|RAPID&lg=EN).

<sup>34</sup> "Beef: Commission will formally adopt exception BSE-measures," *European Commission*, December 13, 2000. Website available at: <http://europa.eu.int/comm/dg06/newsroom/en/54.htm>.

<sup>35</sup> "Portugal: Number of BSE-infected cattle rises in December," BBC Monitoring of *Diario de Noticias*, 19 January 2001. BBC Monitoring website available at: <http://www.monitor.bbc.co.uk/index.htm>. Last visited January 23, 2001. *Diario de Noticias* website available at: <http://www.dn.pt/>.

land, beef, suckler cows, hill livestock, sheep and grain legumes, is applied unevenly throughout the EU.<sup>36</sup> The staff will work to stay abreast of this issue.

As additional countries begin the EU accession process, we will closely monitor their agricultural assistance programs to ensure conformity with WTO obligations, paying particular attention to the cattle and beef industries. Since many of the countries which may desire to become EU members are heavily agricultural, particular concerns remain about their assistance programs. For example, at an emergency meeting in late 2000, the Latvian government approved larger subsidies for its agricultural sector than had been approved for the year 2000.<sup>37</sup> Nearly thirty percent of this agricultural aid was to be used for development of cattle breeding. Additionally, the EU recently signed the "Multi-annual and Annual Financing Agreements" with candidate countries to help provide pre-accession aid to those countries' agricultural sectors and rural development. The SEO will continue to monitor the operation of these agreements as candidate countries move closer to EU accession.

### Austria

In Austria, information on one program which may apply to the cattle and beef industries was uncovered.<sup>38</sup> The program, *Regional Planning Assistance Focal Point Program (RPAFPP) 1996-2000 - Focal Point: Assistance to Initiatives in the Field of Agricultural Marketing*, was to be terminated on December 31, 2000. The objective of this program was to provide economic assistance to marketing measures taken by Tyrolean farmers. The aid under this program took the form of cash grants and was provided exclusively to individual farmers and to agricultural enterprises. The SEO will pursue further information on this program to determine whether it was terminated and whether or not it was replaced with a similar program.

### Belgium

Likewise, information on one Belgian program that could apply to the cattle and beef sectors was found: *Aid for Agricultural Investment and New Enterprise Under the Flemish Agricultural Investment Fund*. Aid under this program took three forms:

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<sup>36</sup> Rupert Cocke, "UK Farmers Concerned That IACS Rules Vary Within EU - NFU ", *Dow Jones Newswires*, January 17, 2001.

<sup>37</sup> "Latvian government approves agriculture subsidy programme for 2001," *BBC Monitoring*, December 27, 2000.

<sup>38</sup> "Updating Notification Pursuant to Article XVI:1 of the GATT 1994 and Article 25 of the Agreement on Subsidies and Countervailing Measures: Austria," (G/SCM/N/60/EEC/Add.1), September 27, 2000.

- *Interest Subsidies:* Interest subsidies are granted on loans for agriculture and horticulture improvements and start-ups.
- *Premiums on Investments:* Grants are provided for start-ups by young farmers/horticulturalists. Up to 50 percent of the grant is co-financed by the European Agricultural Guidance and Guarantee Fund.
- *Guarantees for Loans:* Guarantees are granted for agriculture and horticulture.<sup>39</sup>

## Denmark

Denmark has a number of agricultural programs that may apply to cattle and beef. They include:

- *Refinancing of Mortgage Loans Etc. in Agricultural Holdings:* This program provided loans for 10 or 30 years. Final applications for this program were accepted until December 15, 1989.
- *Subsidy for Agricultural Indexed Loans Granted in Connection with Refinancing of Mortgage Loans:* It was intended that this program would help ease the financing cost for farmers by reducing the payment on certain indexed loans. Loans under this program were for 10 or 15 years. Final applications were accepted until December 15, 1989.
- *Subsidy for Payment of Agricultural Indexed Loans:* This program was offered to reduce the financing costs in agriculture by subsidizing the payment on certain indexed loans. Final applications for this program were accepted until 1990 with financial commitments extending for 15 years.
- *Debt Rescheduling Scheme for Farmers (Loans and Interest Subsidy):* This program helped farmers hit by financial crisis to reschedule their debt. Aid under this program took the form of a loan guarantee or subsidized interest payments. Final applications for this program were due in 1983. Loans ranged from 13 to 23 years.
- *Debt Reorganization for Farmers (Loan):* This program helped farmers to reschedule short-term high interest mortgage loans. Final applications for this program were accepted until April 1, 1994. Loans were for 15 years.

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<sup>39</sup> "Updating Notification Pursuant to Article XVI:1 of the GATT 1994 and Article 25 of the Agreement on Subsidies and Countervailing Measures: Belgium," (G/SCM/N/60/EEC/Add.2), August 23, 2000.

- *Aid Scheme to Benefit Less-favored Agricultural Areas:* This program provides a yearly grant to farmers and livestock units in less-favored areas which are the islands of Samsø, Læsø, Fanø and 27 small islands under the association of small islands in Denmark.
- *Aid to Promote Development of Agricultural and Fishery Products:* Under this program, aid can be given to (1) the development of new products in the primary agricultural and fisheries sector; (2) the development of processed products in the agricultural and fishing industry; and (3) the marketing of products from the agricultural and fishery sector.
- *Aid for Investments in Animal Welfare:* Under this program, farmers making animal welfare investments in agricultural buildings receive an annual payment of four percent for 10 years. For other investments in animal welfare, an annual payment of 2.5 percent is granted for seven years. For new entrants below 40 years of age, payments are increased to five percent.<sup>40</sup>

#### Finland

Finland had two agricultural programs due to expire at the end of 1999. One program, *Investment Aid for Businesses Processing Agri-Based Products*, was due to be replaced in 2000 with a new investment and development program. Another program, *Aid for Development Projects in the Food Industry*, is designed to “improve the competitiveness of the food industry in the long run by activating enterprises to adjust their business activities to the changed operating environment due to the EU membership.” Aid under this program, which was provided in the form of a grant, could be provided for projects until 1999.<sup>41</sup> The SEO will further investigate whether the program was renewed for the following years.

#### Germany

In a December 2000 *BBC Monitoring* article, the former German Agricultural Minister, Karl-Heing Funke, called for a change in the subsidy system in the farming sector.<sup>42</sup> While calling for “transparent production” in the beef sector, Funke also said that in the future, government subsidies should be aimed towards businesses that “join a vertical and horizontal integrated system.”<sup>43</sup> SEO staff intend to monitor developments in this area.

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<sup>40</sup> “Updating Notification Pursuant to Article XVI:1 of the GATT 1994 and Article 25 of the Agreement on Subsidies and Countervailing Measures: Denmark,” (G/SCM/N/60/EEC/Add.3), June 15, 2000.

<sup>41</sup> “Updating Notification Pursuant to Article XVI:1 of the GATT 1994 and Article 25 of the Agreement on Subsidies and Countervailing Measures: Finland,” (G/SCM/N/60/EEC/Add.4), June 14, 2000.

<sup>42</sup> “German Minister calls for “transparent” beef production,” *BBC Monitoring*, December 28, 2000.

<sup>43</sup> “German Minister calls for “transparent” beef production,” *BBC Monitoring*, December 28, 2000.

## Ireland

Several programs in Ireland appear to involve the cattle and beef industries including:

- *Scheme of Premiums for Maintaining Pure Bred Kerry Bovine Herds*: Support under this program provides fixed grant amounts per unit to breeders of pure bred Kerry cattle.
- *Winter Fodder Scheme 1998*: This scheme provided grants in 1998 and continued in 1999. Details were not yet available as to whether aid was granted in 2000 or would be granted in 2001.
- *Scheme of Assistance for Winter Fodder Losses 1999*: Grants under this program commenced in March 1999.
- *National Scheme of Investment Aid for Control of Farm Pollution*: In addition to aid for the control of farm pollution, grants under this program could be used towards winter housing for cattle and sheep, fodder storage and ancillary farmyard facilities.
- *National Scheme of Investment Aid for the Improvement of Dairy Hygiene Standards*: Grants under this program were scheduled to cease at the end of 2000. Details are not yet available as to whether a replacement scheme was instituted for 2001 and subsequent years.<sup>44</sup>

## Japan

The United States held a 57 percent share of Japan's beef imports in 1999.<sup>45</sup> Japanese beef imports for 2000 are not expected to vary much from 1999's level of nearly

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<sup>44</sup> "Updating Notification Pursuant to Article XVI:1 of the GATT 1994 and Article 25 of the Agreement on Subsidies and Countervailing Measures: Ireland," (G/SCM/N/60/EEC/Add.8), August 24, 2000.

<sup>45</sup> "Japan Livestock and Products Annual 2000," *United States Department of Agriculture, Foreign Agricultural Service*, Global Agricultural Information Network Report #JA0083, August 1, 2000. Please note, in the FAS "Livestock and Poultry: World Markets Update" of October 2000, it is reported that forecasts for Japanese imports of cattle are approximately 990,000 carcass weight equivalent. This report is accessible on the Internet from the FAS website available at: <http://www.fas.usda.gov>.

700,000 metric tons.<sup>46</sup> The FAS reports no Japanese beef exports in 1999 or 2000.<sup>47</sup> The aid programs available to domestic Japanese producers of cattle and beef include:

- *Deficiency Payment Scheme for Feeder Calves:* Funded by Japan's Ministry of Agriculture, Forestry and Fisheries (MAFF), this price support program involves "market intervention by the Agriculture and Livestock Industries Corporation (ALIC) (a quasi-governmental organization)<sup>48</sup> to keep prices for beef and pork within the price stabilization range."<sup>49</sup> Under the terms of this program, registered feeder calf growers are eligible to receive a deficiency payment when quarterly average auction prices for their feeder calves fall below the "guaranteed price" which is determined by MAFF.<sup>50</sup>
- *Prefectural Feeder Calf Producer Fund:* Under this program, which is funded by MAFF through the ALIC, feeder calf producers who are registered in the previously discussed *Deficiency Payment Scheme* are automatically enrolled in this fund. Contributions from feeder calf producers are paid to the prefectural beef calf producer associations who operate the fund. This fund is mostly used to protect producers from rapid price declines.<sup>51</sup>
- *Debt Financing Measure:* This is a low-interest loan program for livestock farms which can be used for various purposes, including modernization of facilities and repaying debt loans.

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<sup>46</sup> "Japan Livestock and Products Annual 2000," *United States Department of Agriculture, Foreign Agricultural Service*, Global Agricultural Information Network Report #JA0083, August 1, 2000.

<sup>47</sup> "Japan Livestock and Products Annual 2000," *United States Department of Agriculture, Foreign Agricultural Service*, Global Agricultural Information Network Report #JA0083, August 1, 2000.

<sup>48</sup> The Agriculture and Livestock Industry Corporation (ALIC) was formerly called the Livestock Industry Promotion Council. As a quasi-governmental organization, ALIC is responsible for implementing the government's agricultural schemes and disbursing assistance payments to the feeder calf growers.

<sup>49</sup> "Administrative Livestock Prices Determined," Ministry of Agriculture, Forestry and Fisheries Update, April 14, 2000, number 355. Website available at: <http://www.maff.go.jp/mud/355.html>. Last visited January 11, 2001. In March 2000, MAFF agreed to a 14 percent reduction, from the 1999 fiscal year level, for the price support program.

<sup>50</sup> "Japan Livestock and Products: Japanese Beef Cattle Subsidy," *United States Department of Agriculture, Foreign Agricultural Service*, Global Agricultural Information Network Report #JA1002, January 9, 2001, page 2.

<sup>51</sup> "Japan Livestock and Products: Japanese Beef Cattle Subsidy," *United States Department of Agriculture, Foreign Agricultural Service*, Global Agricultural Information Network Report #JA1002, January 9, 2001, page 2.



- *Beef Cattle Farming Stabilization Support Measure:* This program lowers farm input costs for various operations including beef cattle feeding operations and beef breed cow rearing operations.
- *Livestock Environmental Control Support:* This program assists farmers in obtaining manure and pollution equipment.
- *Low Cost Farming Promotion and Support:* Under this program, assistance is provided to support beef cattle farmers with better farming technology to reduce costs.
- *Animal Health and Livestock Products Safety Support:* Aid under this program is provided to livestock farmers to assist with various livestock disease control measures.
- *Meat Processing, Market and Promotion:* The results of this public relations program are directed at consumers and include cooking contests, and promoting new model meat processing facilities equipped with high safety standards.<sup>52</sup>

According to the WTO Trade Policy Review of Japan, it was noted that Japan is moving more towards income support for agriculture, rather than price support.<sup>53</sup> The review also noted that Japan's agricultural sector remains relatively well-protected from foreign competition, largely through high tariffs on imports.

In the first half of 2000, Japan suffered from two outbreaks of foot and mouth disease in its cattle. The onset of the disease was attributed to imports of hay, largely used for livestock feed, from China.

SEO staff will continue to examine the agricultural situation in Japan, including the government's implementation of its new "Basic Law for Food, Agriculture and Rural Areas" which was enacted in July 1999 and set the direction for future agricultural policy.<sup>54</sup> In addition, in a recent interview, Mr. Nagamura, Director General of the Livestock Department, Agricultural Production Bureau, Ministry of Agriculture, Forestry and Fisheries, said that Japan's WTO negotiating position on beef, pork, and dairy products would soon be made obvious. He added, "I would not anticipate that Japan will drastically lower the present hurdles

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<sup>52</sup> "Japan Livestock and Products: Japanese Beef Cattle Subsidy," *United States Department of Agriculture, Foreign Agricultural Service*, Global Agricultural Information Network Report #JA1002, January 9, 2001, page 3.

<sup>53</sup> "Structural Reforms: The Key to Japan's Economic Recovery," *World Trade Organization*, Press Release document symbol PRESS/TPRB/142, 6 November 2000, page 8. Released on November 16, 2000.

<sup>54</sup> A provisional translation of the Basic Food Law can be found on Japan's Ministry of Agriculture, Forestry and Fisheries website. This is available at:  
<http://www.maff.go.jp/soshiki/kambou/kikaku/NewBLaw/BasicLaw.html>.

of border treatments such as deficiency payments, beef cattle subsidy, meat regimes, etc.” In the same interview, Nagamura further said that Japan would not recede much from its current level of protection.<sup>55</sup> Japan's proposal, later submitted to the WTO, notes the importance of subsidies and calls, *inter alia*, for “improving” Green Box rules, including by the loosening of the some of the terms and conditions, and being “realistic” about determining Aggregate Measure of Support (AMS) commitment levels in order “not to undermine the benefits gained ... from the multifunctionality of agriculture, ...[and] to keep pace with the progress of domestic agricultural policy reform.”

### **New Zealand**

The U.S. market is the largest market for New Zealand's beef exports. However, those exports are limited to an annual tariff rate quota of 213,402 tons per year, which was filled for the first time in November 2000.<sup>56</sup>

Despite the fact that, in 1999, support provided to New Zealand farmers, as measured by the OECD Producer Support Estimate (PSE), remained the lowest in total and percentage terms of any country in the OECD, there are various aid programs which the Government of New Zealand offers to its agricultural sectors which could benefit the cattle and beef industries.<sup>57</sup> These programs include:

- *Sustainable Farming Fund*: This program was announced on September 6, 2000, and provides money for “projects that enable access to information, technology, or tools, and that bring together communities to address problems and improve the community economic base.”<sup>58</sup>

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<sup>55</sup> “Japan Livestock and Products: WTO Negotiations and Livestock: MAFF Offers a Glimpse of its Position,” *United States Department of Agriculture, Foreign Agricultural Service*, Global Agricultural Information Network Report #JA1004, January 16, 2001, (FAS translation of remarks).

<sup>56</sup> “New Zealand Agriculture and Forestry: Situation and Outlook, December 2000,” *New Zealand Ministry of Agriculture and Forestry*, December 2000. Website available at <http://www.maf.govt.nz/MAFnet/publications/SONZA/s&o1000/httoc.htm>.

<sup>57</sup> According to the OECD, the PSE “is an indicator of the annual monetary value of gross transfers from consumers and taxpayers to agricultural producers, measured at the farm-gate level, arising from policy measures that support agriculture, regardless of their nature, objectives or impacts on farm production or income.” See “Agricultural Policies in OECD Countries 2000: Monitoring and Evaluation,” *Organization for Economic Cooperation and Development*, 2000, pages 20 and 100.

<sup>58</sup> “Rural Bulletin: November 2000,” *New Zealand Ministry of Agriculture and Forestry*, November 2000, Updates section. Website available at: [http://www.maf.govt.nz/MAFnet/publications/ruralbulletin/rbnov00/rbnov00-17.htm#P465\\_58028](http://www.maf.govt.nz/MAFnet/publications/ruralbulletin/rbnov00/rbnov00-17.htm#P465_58028).

- *Public Good Science Fund*: Preliminary research revealed that this fund grants aid to *Meat New Zealand* (MNZ), which is the new name of the New Zealand Meat Board, a statutorily established organization. The aid granted under the Public Good Science Fund is intended to be used for research and other purposes. Although its website states that Meat New Zealand is fully funded by pastoral farmers, further research revealed that MNZ officially reports to the Ministry of Agriculture and Forestry and was partially and initially funded by funds from the federal government.<sup>59</sup>
- *Trade Access Support Programme - Funding For Export Markets (TASP)*: This program is administered by New Zealand's Trade and Economic Analysis Division of the Ministry of Foreign Affairs and Trade (MFT) and assists New Zealand exporters in gaining better access to overseas markets by helping exporters who face discriminatory product standards, labeling requirements, quarantine restrictions, and other government regulations.<sup>60</sup>

SEO staff will continue to monitor the assistance described above, as well as a new export credit guarantee scheme announced in November 2000. While details of this scheme have not yet been announced, the government expects the program to be operating by March 31, 2001.

### **Republic of Korea**

Korea is a major importer of food products. Consumption of beef products has risen quickly following the end of the economic crisis in 1998, and imports are rising to meet the renewed demand. The United States is the dominant supplier of beef to the Korean market, providing 58 percent of total beef imports in 1999.<sup>61</sup> Other major exporters to Korea include Australia, Canada, and New Zealand. On January 1, 2001, Korea's beef and live cattle markets were liberalized. Restrictions on imports were replaced with tariff measures. Korea did not export beef or cattle between 1998 and 2000.

Korea's domestic cattle herd was affected by detection of foot and mouth disease in March 2000. In an effort to stop the disease's spread, over 2,000 cattle were destroyed in 15 quarantine areas. The Ministry of Agriculture and Forestry announced 476 billion won in

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<sup>59</sup> Further information on Meat New Zealand and the New Zealand Meat Board can be found on their website at: <http://www.nzmeat.co.nz/DEFAULT.HTM>.

<sup>60</sup> "Business Files: Trade Access Support Programme - Funding for Export Markets," *New Zealand Ministry of Foreign Affairs and Trade*. Website available at: [http://www.mft.govt.nz/help/file/trade\\_access.html](http://www.mft.govt.nz/help/file/trade_access.html).

<sup>61</sup> "Korea, Republic of, Livestock and Products, Annual 2000, Global Agricultural Information Network Report #KS0090," *United States Department of Agriculture, Foreign Agricultural Service*, August 2, 2000.

support for countering foot and mouth disease in swine and cattle populations in Korea.<sup>62</sup> Farmers were compensated at the full market value for the destroyed animals.

U.S. beef exporters should continue to experience improved opportunities in the Korean market. Low domestic inventories and the established market presence of U.S. beef should allow U.S. exports to continue to experience growth in the Korean market.<sup>63</sup>

Korea's livestock support program, *Government Purchase of Beef*, was introduced provisionally in order to support beef prices and farmers' income.<sup>64</sup> In 1998, 247.1 billion won were provided to recipients under this aid program. The program was suspended in early 1999, when beef prices increased. In June 2000, the Korean Ministry of Agriculture introduced a new "quality beef" production program that is meant to enhance the competitiveness of domestic Hanwoo beef versus imported beef.<sup>65</sup> The program is based on a bonus incentive system for producers and pays 100,000 won per Hanwoo bull calf at the time of neutering. The program is primarily financed by the central government.

The Korean government has also established deficiency payments to cattle breeders in order to support and maintain a calf-breeding sector in the face of expected increased beef imports.<sup>66</sup> Begun as a pilot project in 1999, a stabilization price is set which takes into account production costs, breeding trends and other factors. In 2000, the program was extended to all areas and deficiency payments of up to 200,000 won (\$169) per calf were authorized.

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<sup>62</sup> "Korea, Republic of, Livestock and Products, Special Budget Secured to Meet Foot and Mouth Disease Hit Livestock Farmers 2000, GAIN Report #KS0048," *United States Department of Agriculture, Foreign Agricultural Service*, April 20, 2000. Unofficial translation of GOK press announcement.

<sup>63</sup> Ibid.

<sup>64</sup> "Updating Notification Pursuant to Article XVI:1 of the GATT 1994 and Article 25 of the Agreement on Subsidies and Countervailing Measures: Korea," G/SCM/N/60/KOR, *World Trade Organization*, July 13, 2000.

<sup>65</sup> "Korea, Republic of, Livestock and Products, Annual 2000, Global Agricultural Information Network Report #KS0090," *United States Department of Agriculture, Foreign Agricultural Service*, August 2, 2000.

<sup>66</sup> "Agricultural Policies in OECD Countries 2000: Monitoring and Evaluation," *Organization for Economic Cooperation and Development*, 2000.

## Uruguay

Uruguay produces and exports large quantities of live cattle and beef. As a country with high and stable levels of consumption, increased production has been achieved through better management and increased efficiency. A drought in 2000 is expected to temporarily reduce the herd size and total exports in 2001. Uruguay has a 20,000 MT tariff-rate quota (TRQ) for its beef exports to the United States. Although Uruguay met the quota for the first time in 1999, it will likely fill its entire quota in 2000 and 2001. The Uruguayan government seeks to increase this quota significantly and has raised the possibility with the United States about increasing in-quota access to the U.S. market with countries not currently filling their quotas. Uruguay's main beef export markets include the EU, Israel, the United States, Brazil and Canada. Uruguay is also attempting to enter markets in Asia.

Opportunities for beef exports from the United States to Uruguay are limited due to adequate local and regional supplies and the common Mercosur tariff, which ranges from 3 to 23 percent for most products. Brazil provides much of Uruguay's imports of cattle and beef.

Uruguay's exports of grass-fed cattle have risen steadily but are expected to contract briefly in 2001. Most of the live cattle exported are "feeders" which go to Argentine feedlots. Exports of live cattle to Mexico have also increased.<sup>67</sup>

Our initial research indicates that the Government of Uruguay does not provide direct financial support to livestock producers for the production of beef or cattle. Beef producers in Uruguay do receive limited assistance from the National Meat Institute to participate in international food shows and tastings.<sup>68</sup> The Institute helps producers promote Uruguay's beef as "Natural Meats." The FAS has reported that Uruguay has a 5.5 percent export rebate for boneless beef and 2.25 percent for bone-in beef.<sup>69</sup> While the rebate of indirect taxes is permissible under the WTO Subsidies Agreement and U.S. law, it must be shown that the rebate was appropriately calculated and is not in excess of the amount of indirect taxes paid.

## Conclusion

In this report, we have identified numerous measures and issues that may be of interest to the U.S. cattle and beef industries, and that are deserving of further research and attention. We will continue to work with the representatives of these industries to ensure that they are

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<sup>67</sup> One of the Congressional letters received by the SEO raised a "transshipment" issue with respect to cattle from Uruguay. This issue was referred to the USDA.

<sup>68</sup> "Uruguay Livestock and Products, Annual 2000, Global Agricultural Information Network Report #UY0001," *United States Department of Agriculture, Foreign Agricultural Service*, August 1, 2000.

<sup>69</sup> Ibid.

fully aware of important potential subsidy practices which may be benefitting their competitors abroad.